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The Non-Stoppage Strike

George W. Goble
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. SUBSTITUTE that the law could make vailable as an alternative to the tradi- ional strike or lockout in labor dis- utes is the "non-stoppage strike." This ype of strike would protect the public nterest and yet not modify the relative argaining power of management and abor. The adoption of this plan would equire that the National Labor Rela- ons Act be so amended that a non- toppage strike agreement could be nade by any employer and his em- loyees. By this contract the employees vould agree not to slow down or stop vork collectively, and the employer vould agree not to initiate a lockout r abnormally reduce his labor force uring the period of any controversy; nd both would agree that during a ontroversy the non-stoppage strike rocedure would be followed. A viola- on of the agreement by either party vould constitute an unfair labor ractice.

The Plan

The essentials of this plan would be s follows:

When a dispute arose between man- gement and labor and they failed to each an agreement through the usual rocedures, and the situation had eached the point where under the resent law the employees were privi- ged to strike, either labor or manage- ent could make application to the ational Labor Relations Board for a on-stoppage strike order.

Acting upon this application the oard, after determining that there was a bona fide dispute, would issue an order for work to continue, with management and labor subject to agreed penalties until a settlement of the dispute was effected.

The employing company would be required to file with the Board such books and records as would be necessary for the Board to determine the approximate current net earnings of the company. The method for determining this amount would vary with different types of business. Normally a tentative figure would be reached by using the net earnings for the fiscal year immediately preceding the date of the application, as determined by the accounting methods then in use by the company and as certified to by a certified public accountant. For construction companies the tentative amount would be determined for the construction project rather than by the year.

The tentative net earnings once determined, the Board would then issue an order requiring the company to segregate a pro rata part of them weekly, and to deposit the amount in a designated bank to the credit of the Board. At the same time all wages and salaries of all employees of the company, from the president on down, including all representatives of management as well as all laborers represented by the union, would be ordered reduced 25 percent, and this 25 percent deducted from the payroll would be deposited in a segregated account to the credit of the Board. Further, the

Board would require that the company pay no dividends and add nothing to its surplus during the period of the controversy and that no strike benefits be paid by either labor or management.

The work of the plant would continue, and while it continued the parties would be required to bargain collectively until agreement was reached. If agreement were not attained within 90 days, the segregated funds deposited to the credit of the Board would be forfeited to the United States Government. The same procedure would then be repeated for another 90 days, and so on until agreement was finally effected. When agreement was reached, such segregated funds as were then on deposit and not forfeited to the government would be released by the Board, the wages and salaries fund to be apportioned among the employees from whom it had been taken, and the segregated net profits fund to be paid to the company.

If at the end of the current accounting period it became evident that the amount previously forfeited actually exceeded the company's net earnings for the period covered, the government would refund to the company the amount of such excess, or if it appeared that the forfeited amount was less than net earnings for the period covered, the company would be required to pay the government the difference.

It would be an unfair labor practice, after an agreement embodying a non-stoppage strike clause had been made, for a company to change its accounting procedures in such a way as to affect its net earnings; or, during the continuance of a non-stoppage strike to reduce below normal its labor force, taking into account the seasonal or fluctuating character of its business; or to discharge an employee for other than a cause now legally justifiable; or to pay any of its officers or employees strike benefits. On the side of labor, it would be an unfair labor practice for employees collectively to slow down or stop work, or for strike benefits to be paid to employees during the period of a controversy.

In the case of a company which operates more than one unit or branch, if a non-stoppage strike were called in one of them, only the laborers employed in that branch would suffer the wage reduction. But all representatives of that plant's management, whether located there or elsewhere, would suffer the salary reduction. The net earnings to be deposited to the credit of the National Labor Relations Board in such a case would be those of that branch only, the amount to be determined either by the accounting records of the branch, or by ascertaining the branch's proper proportionate part of the earnings of all the plants of the company.

The proposed plan would in no way affect the power which the government now has of taking over and operating any essential industry in a national emergency.

The Theory of the Non-Stoppage Strike

The purposes of the non-stoppage strike are: (1) to substitute a new sanction (method of inflicting injury) for the traditional strike and lockout; (2) to neutralize or eliminate the stop work or lockout procedure as a facto

collective bargaining; (3) to pre-
rve the established balance in eco-
omic bargaining power as between
anagement and labor; and (4) to
abilize the national economy.

In a dispute between labor and man-
gement the regular strike is a power-
l weapon in the hands of labor be-
use of the economic injury which it
ables labor to inflict upon manage-
ent. However, that injury comes
out not as a direct result of stopping
e plant, but as a result of stopping
e plant's income. The main target of
strike is the employer's profits. If the
w of income into the employer's till
ere not interrupted, the strike would
a very blunt and ineffective weapon.
if the employer's income could be
rectly hit without stopping work,
bor would retain the bargaining ad-
ntage of a regular strike, and the
blic would be spared the economic
ss resulting from curtailed produc-
on. That is the purpose of the non-
oppage strike. However, in order to
event the corporate-entity fiction
om protecting the corporation's policy
akers from injury, their personal in-
mes should be subjected to reduction.
njoining profits would injure the
ockholders of the company. Reducing
laries would injure those who make
e company's policies.

But if an employing company were
prived of its entire income it could
t continue to operate. To operate, it
ust continue to pay the cost of main-
nance, its accrued debts, its interest,
taxes, and its current expenses. It
ould be permitted, therefore, to re-
in as much of its income as will
able it to do this. This means that
e amount to be taken from the company should be no more than *net* profits. Hence, during a period of controversy, the company could not pay dividends, or enlarge surplus, but it could continue to operate the business.

In the case of a company found by the Board to have been operating without net earnings or at a loss, the coercion applied by the order of the Board to management would consist only in the salary reduction of its officers and other policy-making representatives and the prohibition of the payment of dividends and of the accumulation of a surplus during the period of the controversy. But since the company would be already operating without profits, its economic power relative to labor would be the same as that of a company whose profits were forfeited. It is neither necessary nor desirable to inflict as much injury upon a company already economically weak as upon one economically strong. And to penalize it further would destroy its power to continue to employ its labor force and to serve the public.

The regular strike, however, is a double-edged sword. Once labor puts it into execution it cuts both ways. It inflicts a severe injury upon labor as well as upon management. It stops all wages. Employees must draw upon their savings for living expenses or live on strike benefits paid by the union. This is an economic factor which materially enhances the bargaining power of management. It is thus seen that when a strike is called, each party inflicts an economic injury upon the other and both upon the public, and frequently the only question is who can endure the suffering the longest. Of course, before labor strikes it always

weighs its impending economic injury against the chances of gaining enough not only to repair this injury but to add something on top of that.

In the case of a lockout, the company rather than labor is the moving party. However, the economic considerations in the two situations are essentially the same. Hence the same procedures for settlement should be applied.

Does the Plan Preserve the Existing Balance of Power?

It is to be noted that a controversy of less than 90 days' duration involves only a comparatively small loss on both sides: namely, by management, of the *use* of 25 percent of salaries and the *use* of all net profits, and by labor of the *use* of 25 percent of wages, during the period of controversy. Only if the dispute continues beyond 90 days does a substantial forfeiture occur. However, it is the intent that the very threat of this forfeiture shall cause both parties to exert every effort toward a settlement before the loss actually occurs.

It is clear that the calling of a non-stoppage strike should be accompanied by prospective penalties to labor. Otherwise it would be called for small or imagined grievances, and sincere and earnest efforts for prompt settlement would be discouraged. On the other hand, the calling of a non-stoppage strike should not be accompanied by penalties of too drastic a nature. If it were, labor could not afford to use it and would never agree to the inclusion of such a clause in a collective-bargaining contract. Likewise with respect to management, the non-stoppage strike must carry its prospective penalties. Otherwise it would have no effect as a weapon in the hands of labor. But again these penalties should not be too severe, or management could not continue to operate; it would not have the strength to resist unreasonable and unjust demands made upon it by labor and would not agree to a contract providing for such procedure.

At the present time, when a strike is called the injury inflicted upon the company is its shutdown expenses plus the loss of *all* its income for the period the plant is closed. On the side of labor, the injury inflicted is the loss of *all* wages during that period. The balance is shutdown expenses and loss of *all* income on the company's side against loss of *all* wages on labor's side.

Under the proposed plan the company has an advantage over the present procedure. It retains enough of its income to pay interest, taxes, accrued debts, and its current expenses, and it saves its shutdown expenses. The injury inflicted upon it is the loss of net profits only. In order to preserve the balance of economic power between the two parties it is therefore necessary to give labor a corresponding advantage over the present system. Seventy-five percent of full wages is believed to be the commensurate advantage.[1] The balance then becomes loss of 25 percent of

[1] Experience may show that this percentage figure should be generally increased or decreased, or that it should be modified for particular industries. This is the variable factor in the economic power equation. Theoretically this factor should always be the amount necessary to keep the bargaining power of labor in proper balance with that of management. Within specified limits—say between 50 percent and 90 percent—the figure itself might possibly be left to the collective bargaining of the parties.

laries and net profit on the company's side against loss of 25 percent of ages on labor's side.

It is thus seen that under the proposed plan each party has power to flict an injury on the other, but the verity of the injury, on both sides, is ss than can be caused under the esent system. The principal effect of is reduction in power to inflict reciprocal loss is not to lessen the power either to coerce the other, but to eaken the power of both to injure e public.

Advantages of the Plan

The advantages of this plan to labor e: (1) instead of receiving no income during a strike or of being reuired to fall back on a small strike enefit payment from the union, all nployees will receive 75 percent of eir regular pay; (2) the demoralizaon which comes from being idle as quired by the regular strike is not esent; (3) the bad feeling and dangers of the picket line are eliminated;) the risk of the company's beating e strike by employing strike breakers avoided; (5) the bargaining power the union is as strong as it is when stop-work strike is used, because nless the company comes to terms, not ly are its profits lost, but 25 percent the salaries of all persons representg the company is sacrificed; (6) the ilure of a company to pay its regular vidends will immediately generate ong pressure among all stockholders r an early strike settlement; and) the work-stoppage strike weapon not permanently lost, since the new ocedure is available only if previously reed to, and if the plan proves unsatisfactory it can be abandoned at the expiration of the contract period.

The advantages to the company are: (1) the bad feeling of employees and damage to property which sometimes result from a picket line are eliminated; (2) all expenses incident to a shutdown are avoided; (3) the disruption which comes to the operation of the business, to its market position, and to the satisfying of customers is prevented; (4) the temptation to resort to unpopular methods for breaking the strike is not present; (5) the bargaining power of the company is maintained, since the employees will lose 25 percent of their wages unless agreement is reached; and (6) the forfeiture of 25 percent of salaries and all net profits in the event of failure to agree is not too severe — it is a smaller loss than would result from closing the shop because of a regular strike.

The advantages to the public are: (1) since there is no curtailment in the production of goods, there is no economic loss to the public; (2) if all labor controversies were settled by this procedure, the national production would be boosted by many millions, and thus a higher standard of living all the way around would be made possible; and (3) since other plants dependent upon the product of the plant involved would not be required to close, and the employees of such other plants would not be required to quit work, the uninterrupted flow of goods to the public and continued full employment would be maintained.

The plan thus constitutes an economic saving over the present system to labor, to management, to dependent plants, and to the public, without call-

ing for the sacrifice by either capital or labor of its relative economic bargaining power.

Will the Parties Agree to the Proposal?

Assuming that the proposed plan preserves the balance in economic power between management and labor, the parties should be able to reach an agreement to substitute it for the present system, because it will constitute a financial saving to both. During the period of a dispute, labor would receive 75 percent of its wages instead of none, with a chance of receiving 100 percent if the controversy is settled within 90 days. Management would receive enough income to pay costs of maintenance, interest, taxes, and current expenses instead of nothing at all, with a chance of receiving all its income if the controversy is settled within 90 days. In the meantime the public would be protected and dependent plants would continue to operate. The sore spot on the body politic would be isolated and sealed.

Enhancing the possibilities of agreement to a non-stoppage strike clause are these factors. In most industries both labor and management earnestly desire to avoid strikes. The difficulty now is that labor has no alternative to the conventional strike for bringing economic pressure to bear upon management. The law simply offers nothing. That is the reason why labor so tenaciously holds on to the strike procedure. Will not both management and labor be willing to try an alternative plan if the law makes it available and gives it sanction? If they will, then it it is altogether probable that experience can be relied upon to gradually develop the initial trial plan, which this proposal is, into a workable system for avoiding work-stoppage.

Will the Plan Facilitate the Settlement of Disputes?

When a traditional strike is called, neither party knows how costly it will be. Frequently each party expects, or at least hopes, that the strike will bring early settlement and therefore cost little. But losses incident to the strike are of the creeping-paralysis variety. Each day adds a little to the total. There is no inducement to settle on any particular day, because the loss for that day will be just like the loss of any other day — a little added to the total. As a result the parties drift into tremendous losses without having had a clear opportunity to avoid them until it is too late.

Under the proposed plan the 90-day clause makes possible the building up of a heavy penalty which will drop suddenly on the parties on the 91st day of the dispute, if they have not reached a settlement by the 90th day. The parties know in advance the amount of the impending loss. They know that failure to agree will cause it, and that agreement will prevent it. This condition introduces a powerful psychological factor in favor of settlement, which is not found in the present system. This psychological factor is the tendency of a person when faced with a loss that is certain and imminent to avoid it if he can, by acting immediately. A day-by-day or week-by-week loss, instead of the 90-day built-up forfeiture, would not carry this advantage.

However, even if these factors do not prove sufficient to bring settlement, and the strike continues, the public would not be harmed and the United States Treasury would be enriched.

Is the Non-Stoppage Strike Proposal Valid?

The proposal is to amend the National Labor Relations Act so that any company and its employees may contract that in the event of a dispute between them, and the exhaustion of other remedies now required by law, either labor or management by notice to the National Labor Relations Board may invoke the non-stoppage strike procedure. The non-stoppage strike plan would be set out in the statute, and when agreed to would become a part of the contract. Both parties therefore, in advance of any dispute, would agree to the use of the procedure and to all its penalties. Contracts of employees not represented by the union would be made subject to the non-stoppage strike procedure. Hence there would seem to be no constitutional objection to the proposal.[2]

However, by the common law a contractual provision which provides for the infliction of a penalty, as distinguished from the assessment of liquidated damages, has long been regarded as contrary to public policy and void. A contract containing the non-stoppage provision would fall into this category. But the common-law principle can be changed by statute. Courts on numerous occasions have upheld contracts providing for penalties where there is statutory sanction for such contracts. It is true that these are usually cases in which one contracting party is required to pay a penalty to the other. The non-stoppage provision requires that the penalty be paid to a third party, the United States Government. But the fact that the penalty is payable to a third party raises no question of legality. Third-party beneficiary contracts have long been recognized as socially and economically desirable and therefore as enforceable.

May the National Labor Relations Board be empowered by statute to examine the books of an employer for the purpose of determining net profits? Numerous Federal and state boards have power to require the production of books, papers, and documents bearing upon matters properly before them for decision. There is no reason why the National Labor Relations Board cannot be granted the same power. May the Board be empowered to order the sequestration of funds? I think so. Although the Board will have no agency for enforcing such an order, it can be given authority to apply to the courts when its request is refused. This is common practice with other administrative boards.

[2] Marceau and Musgrave in their valuable article "Strikes in Essential Industries: A Way out," 28 *Harvard Business Review* 286 (1949), advocate a statute directly imposing financial penalties as a substitute for strikes in essential industries in national emergencies. However, the statute would in effect make it a crime for management and labor to fail to come to an agreement and therefore (as the authors acknowledge) would be unconstitutional.

Their plan also would seem to be impracticable in proposing that the penalties to be imposed should be equivalent to the losses that now result from the conventional strike. Such heavy penalties cannot be inflicted if the plant is to continue to operate and also to pay wages and costs of operation.

Will Congress Approve the Plan?

The proposal is to amend the National Labor Relations Act so that it will authorize or permit the insertion of a non-stoppage strike clause into a collective bargaining contract. The amendment will not *require* the insertion of the clause nor impose any penalty for not inserting it. If the parties in any case choose not to include it, the right of labor to use the work-stoppage strike is left unimpaired. In other words, the law will only make the use of such a device available if management and labor in any particular case desire to use it. This could cause no harm. It might produce a far-reaching good.

Objections to the Plan Considered

This plan has been discussed with a number of the writer's colleagues, and many of their valuable criticisms have been incorporated as modifications of the original idea. Certain objections that seem likely to be raised in the course of future discussion may now be briefly considered:

(1) *Seventy-five percent of full wages to labor is too much.* It is believed that this amount is no more than adequate compensation to labor for the advantages it surrenders. In agreeing to give up the traditional strike in any particular case, labor surrenders its power to injure its employer by forcing upon it shutdown expenses, the loss of customers and market position, i.e., the power to injure the company as an institution. Labor also loses the benefits of the strike as an emotional outlet, as a means for dramatizing its cause, as a device for developing union loyalty and cohesion, and as an instrument for focusing public attention on its demands. Labor cannot be expected to surrender these advantages voluntarily for less than adequate consideration. Experience may be relied upon for showing whether this balancing figure should remain constant or be moved up or down.

(2) *Labor is asked to surrender too much.* Though labor now has the advantages enumerated under point (1), it does not follow that those advantages cannot be exchanged beneficially. In the first place, it is believed that some of these advantages have been overstressed when the long-range view is taken. For example, when the strike is of such a character and duration that it harms the company as an institution and causes it to lose its market position and its customers, labor harms itself. Such a strike weakens the economic power of labor's own employer to survive among its competitors.

As to the loss of union benefits, there are other channels for dramatization and emotional outlet — for example, meetings, speeches, discussions, and demonstrations. And while the strike develops union loyalty and cohesion, it is also a divisive force, especially as between union and nonunion employees. With the strike in the discard, the union can devote its energies and funds to constructive services calculated to unite all labor. Public opinion that is important is free, uncoerced opinion, not that generated in an atmosphere of high feeling and emergency.

It is submitted, therefore, that labor would do well to surrender these advantages in return for the advantages proposed in the plan.

(3) *The proposal involves additional ɔvernmental intervention in collective argaining.* On the contrary, the plan idens the scope of collective bargain- ıg by making it possible for the parties ıemselves to agree to a substitute for ıe strike.

(4) *A reduction in wages will result : inefficient work by labor.* This is a ɔssibility. But this risk would be re- uced if both sides were made to ɛalize that it is their plan, and that its ıccess depends upon good-faith per- ɔrmance by both parties. Capable nion leadership could assure the plan's ıccess on this score. Furthermore, a ɔwdown would not materially hurt ıe company. It would only decrease ıe amount of the forfeiture required it.

(5) *Try the plan experimentally be- re writing it into the law.* The plan ınnot be tried experimentally without atutory sanction, because by the com- on law a contract providing for a ɛnalty is invalid. Further, since the ɔposal is on an optional basis, the an itself contemplates experiment by ose who are willing to try it.

(6) *Some employees not ordinarily fected by a strike, such as a research aff, should be exempted.* This is prob- ıly true. If so, it should be possible r such groups to be excluded by the llective-bargaining agreement.

(7) *It is too difficult to determine net profits.* The determination of tentative net profits presents no special difficulty since the Board will accept for that purpose the company's figure for net profits for the last preceding fiscal year, as determined by the company's records. The sanctions of the non-stoppage strike plan are such that they will normally bring a settlement within 90 days, and for that period it is only necessary that the *tentative* net profits be determined. Since in the event of a settlement within that time the impounded funds will be refunded, the more complicated problem of determining the *actual* net profits would never be encountered.

In the few disputes running beyond 90 days it would become necessary to calculate the *actual* net profits. It is true that this presents a more difficult accounting problem. But even here the amount would be determined by adopting the company's figure of net profits as calculated at the end of the year during which the strike occurs, *using the company's established accounting procedures.* It would be the duty of the Board's accountants to check these figures and to see that during the year there had been no changes in method which would reflect unfavorably on net profits. It is believed that this is not an insuperable accounting problem.

Economic Research at the Office of Airports

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THE FEDERAL AIRPORT ACT of 1946 directs the Civil Aeronautics Administration (CAA) to prepare annually a national plan for the development of public airports. This plan specifies, by location and type of facility, the projects necessary to provide a system of public airports adequate to meet and anticipate the needs of civil aviation. The Administrator of the CAA is authorized, within the limits of available appropriations, to make grants of Federal funds to sponsors for airport development. In carrying out this mandate, the Administrator is authorized to make such surveys and studies as he may deem necessary.

The present paper describes the economic research carried on by the Research and Analysis Branch of the Office of Airports pursuant to this mandate. This discussion is merited on several grounds. In the first place, it is a case study in the function of economic research in an important governmental program. Second, since this economic research is focused upon the central problem of rational allocation of public resources, it has significance and applicability to other public works and analogous programs. Third, portions of the methodology developed can be taken over with but slight modification by various other governmental and private agencies for other purposes.

The Economic Research Function

The formulation (and annual revision) of the National Airport Plan entails examining and evaluating existing facilities, estimating additional facilities required, and determining the relative urgency of projects for inclusion in the Plan. The first and fundamental step in the planning process is the evaluation of the relative economic need of the various communities of the United States for air transportation. This is the function of the Research and Analysis Branch, which formulates the economic criteria of community aeronautic need, develops methods for measuring the air transportation potential of the various communities, and translates this potential into concrete airport requirements. Individual project recommendations are made by the District Airport Engineers of the CAA District Offices, who in cooperation with state aviation officials and local planning agencies are individually responsible for the formulation of their respective state plans, subject to the coordination of the Regional and Washington offices. The function of the Research and Analysis Branch of the national office is to provide them with the economic methods and materials, with tools, for planning.

When the national airport program began slightly over three years ago, no particular guideposts to economic planning were discernible in this virgin territory. Most of the airports built to that time had been either relief or military projects, and in neither case were the needs of the local or national economy the paramount factor. Towns

ith little air transportation potential ad access to large airports capable of rving metropolitan centers, while me of the latter had inadequate facilies. Moreover, aviation was booming. very town with any civic pride deianded an airport, and every town hich had one wanted a bigger and etter one, or perhaps two.

It was precisely to create order out f this chaotic situation that Congress irected the CAA to develop a plan for nation-wide network of airports eared to the requirements of the naonal economy. The CAA, in turn, ioroughly reorganized and expanded s Office of Airports. One of the inovations was the Research and Analys Branch, which was given a general irective to map out and carry through program of basic economic research esigned to assist in attaining the obctives of the program. The free hand hich the Research and Analysis ranch enjoyed and the patience which ie administrative heads of the Office Airports (Director, Phillips Moore; hief, Airport Planning Division, Paul . Stafford) and the field staff disayed during the earlier part of the search program account at least in irt for the fruit which it has borne.

conomic Character of Communities

The Research and Analysis Branch gan its work with a comprehensive idy of the basic economic characterics of the various communities in the nited States. It studied their ecoomic institutions, the distribution of eir labor force, their trade and comerce, and the various indicators of nsumer purchasing power. On the isis of these studies, it established four classifications of communities, in every population size group. These classifications were:

"Marketing Centers," comprising cities in which wholesale trade is a dominant economic activity.

"Industrials," comprising cities in which the predominant activity is manufacturing.

"Balanced," comprising cities which are about average in both trade and industry.

"Institutionals," comprising cities which are considerably below average in both trade and industry and in which the population is supported primarily by secondary economic activities such as government, finance, and the professions.

The significance of these classifications lies in the fact that each group represents differences in per capita purchasing power, income distribution, and business travel habits, and hence different types of potential for aviation goods and services. In general, Marketing Centers and Institutionals have high per capita indexes in airline transportation; Industrials have low per capita indexes; and Balanced communities have about average for their population size group. The following tabulation demonstrates this fact.

ENPLANED PASSENGERS PER 100 POPULATION, 1948

Population of Cities	*Marketing Centers and Institutionals*	*Balanced*	*Industrials*
250,000 and over..	43.3	14.0	9.8
50,000 - 249,999...	27.0	17.0	10.0
25,000 - 49,999....	34.0	23.0	*
10,000 - 24,999....	30.3	17.1	*

* Insufficient cases

Ownership of aircraft is similarly related to the economic character of communities. In 1949, for example, the "Institutionals" among the large metropolitan districts averaged 17 aircraft registered per 10,000 population, but the "Industrials" averaged only 6.0.

Community Effective Potential

Analysis of a community's economic character, as outlined above, furnishes a base for evaluating its performance level in air transportation, or, if the community has no airline service, for estimating its potential performance.

The methodology was further refined in a study entitled *Effective Community Air Transportation Potential,* which dealt with the problem of measuring the community of interest between various cities. It found that the traffic between any pair of cities varies in accordance with the product of the populations of the two cities, in accordance with the traffic generating power of each of the communities involved, and in accordance with the density of cities in the geographic area, and varies inversely with the distance between them. This led to the formula that the traffic between any pair of cities is roughly proportionate to the product of the populations of the two cities divided by the distance between them, with adjustments for economic character and area density factors. These findings held for all modes of transportation and communication, but were subject to two modifications in air transportation. First, the nature of the present-day vehicle virtually bars commercial air travel between cities which are too close to each other. Second, air transportation is at a premium between communities where the ai distance is pronouncedly shorter tha the ground distance. This method, i conjunction with the type of analysi outlined in *Economic Character o Communities,* permitted a fairly ac curate evaluation of the air transpor tation potential of any community Other studies, namely, *Airline Passen gers* and *Air Mail Potential,* establishe methods for estimating future traffic i these fields.

A different approach was necessar for the treatment of air freight poten tial. A study entitled *Domestic Ai Cargo* rated the various commoditie in American commerce on their "ai candidacy" attributes. The principa criteria used were the wholesale pric of the commodity, its density, concen tration of source of supply, averag distance hauled, average gross margin and perishability or seasonality of th commodity. Ratings were assigned eac commodity. The total number of ai cargo rating units for a commodity field fixed its relative importance in total air cargo tonnage, and the num ber of air cargo rating units assigned a city described its air cargo potential. In addition, this study made a forecast o 1,150,000 tons of cargo for the Unite States by 1955 and forecasts for eac of the 50 leading metropolitan districts

Air Carrier Operations

The next step in the research pro gram was to translate estimated traffi volume into terms of estimated aircraf operations. One problem examined wa that of community ratios of passenger to scheduled aircraft operations for th purpose of segregating terminal loca tions from intermediate stops. Anothe

as the rate of growth of aircraft op-
rations, which was found to be, on
nation-wide basis, approximately ⅔
great as that of passengers. The most
gnificant study in this group dealt
ith the time distribution of airport air
rrier operations, and particularly
ith the degree of operation concentra-
on during peak hours, which are the
trinsic gauge of runway requirements
relation to runway capacity. The
udy *Peak Air Carrier Movements at
irports* established a method for esti-
ating peak-hour operations in relation
annual operations. The standards
tablished were on a sliding-scale basis,
ith peak-hour operations gravitating
ound 0.04 percent of annual opera-
ons for airports with more than 50,-
00 annual air carrier operations up to
168 percent of annual air carrier op-
rations for airports with less than
000 operations a year.

Community Maximum Airport Requirements

Most communities with airline serv-
e potential require at the present time
ly one air carrier airport. However,
e size of airports required varies
idely. Obviously, communities with
avy and long-range traffic should be
rviced by larger type planes than
mmunities with light or short-haul
affic. The Office of Airports has ac-
rdingly established six different air-
ort classifications according to landing
cility characteristics. Runway require-
ents, for example, range between
500 feet in length and 100 feet in
idth for Feeder-type airports to 8,400
et in length and 200 feet in width for
tercontinental Express type airports.
he importance of proper determination of the maximum size airport needed by a community is obvious, not only because of considerable differences in Federal expenditures required per project but also because an airport too large for a community may constitute an undue drain on municipal finances.

Economic standards of maximum community need were accordingly established in a study entitled *Community Airport Requirements.* Two factors were selected as primary criteria: (1) the traffic volume expected for that community, stated primarily in terms of annual airline passengers; and (2) the traffic character of the community, defined in terms of average length of passenger haul. These two factors together largely control the type of aircraft needed to serve a community and hence its airport runway length requirements. Final determination for any community was made, however, after consideration of various modifying factors, among them adequacy of airline service, number of long-haul passengers, and the air service pattern for the area. The study also contains a summary of airport determinations made for use in preparation of the National Airport Plan, which clearly demonstrates the marked conformity of these determinations to community potential. Thus, in the group of large metropolitan districts, Marketing Centers or Institutionals usually received an Intercontinental type airport; Balanced cities a Continental type; and Industrials an Express type airport.

Airport Terminal Activities and Space Utilization

With the completion of the studies on airport runway requirements, the

Branch turned its attention to the problem of airport economic stability, beginning with a study of terminal building activities and space utilization, which is useful to architects in design of terminal buildings and to airport, airline, and concession managements as an operational tool. The basic finding of this study is that practically all activities at the airport are closely related to its passenger volume. The table below shows the average ratios of other activities to the passenger activity by three groups of airports:

	Airport Group by Average Daily Passengers		
	1,000	*200-999*	*40-199*
Persons entering airport terminal building (street side only)	2.0	3.0	3.0
Persons entering airport terminal building (both sides)	2.5	3.5	3.5
Total concession customers	1.6	1.6	2.0
Eating establishment customers	0.7	1.0	2.0
News, gift shop, etc., customers	0.6	0.6	*
Number of lobby occupants	0.8	1.0	1.4
Cars entering terminal area	1.0	1.5	1.5

* No independent concessions of this type.

Since the number of airline passengers is a matter of record at any airport having airline service, these ratios can be used to make estimates of other activities. Thus, an airport which handles approximately 500 passengers a day may expect to have, on the basis of using the averages in the table, approximately 1,500 people entering the terminal building from the street side and 1,750 people through all entrances; about 800 concession customers, of whom about 500 will be patrons of the restaurant, and 300 of the news and novelty counter. Other aspects of the study are analyses of present-day space uses of the airport terminal area and of automobile parking.

Smaller Airports Field

Most of the studies mentioned deal primarily with airports for the accommodation of airline service. The reason is simple; the greatest percentage of funds expended has been in this area. However, the smaller airport field has not been neglected. A study entitled *County Aviation and Economic Data* comparatively evaluates each county in the United States on 10 series of data relating to population, purchasing power, aircraft ownership, and airmen. Studies have also been made of the relationship between aircraft ownership and purchasing power, the time distribution of local and itinerant operations, the location of aircraft owners in relation to airport sites, and the types of facilities and activities at smaller airports.

Role of Field Staff in Research Process

Mention has been made previously of administrative support as a factor in the fruitfulness of the research program. A second factor is the contribution of the Regional and District personnel in gathering data. They conducted, for example, the surveys on terminal building activity and space utilization and on peak-hour aircraft activity discussed earlier. Without their assistance, the economic research program would long ago have bogged down into relative sterility. Nor is this assistance based on altruism, or on lack of other work to do (they are more than sufficiently burdened with their

egular duties). It is instead based on n implicit agreement: the field staff athers the raw data and the Research nd Analysis Branch converts these into lanning tools for their use. The sucess of this arrangement has in effect iven the Branch the resources of a ation-wide research organization.

Application of Economic Studies

As indicated earlier, these studies vere made primarily for the CAA field taff. The District Airport Engineers nust submit a recommendation for ach project, and this recommendation nust make a clear demonstration of eed. It should be reiterated at this oint that economic factors, though of rimary importance, are obviously not he only basis for determining the type nd size of an airport allocated to a ommunity. The area air service patern may be an important modifying actor; for example, if a community vhich requires only a Feeder-type airort can be serviced only on a Trunkne route if it is to have any airline ervice at all, it will probably be assted in building or improving a 'runk-line type airport. Sponsor availbility is another important factor; irespective of community requirements, o Federal funds will be granted except n a matching basis to a duly authored sponsoring agency. Still another tuation is the case of a community vhich may require only a Trunk-line ype airport, but is the best location for n alternate (in bad weather) to a Continental airport serving a communy several times larger. Technical and dministrative factors of this type must bviously be taken into account. They re also clearly outside the province of the economist. In the general framework of the planning process, the economic factors are considered first; they fix the airport requirements of a community in the first instance, pending examination and consideration of the various noneconomic factors involved.

The economic studies are also used extensively in the Washington Office of Airports. Although the individual state plans are the responsibility of the local and regional CAA officials, the Washington Office has the function of merging all the state plans into one unified National Plan. It reviews the various state plans for conformity to national standards. It reconciles conflicting state claims. Then too, the Washington Office often makes special studies of particularly knotty situations. Thus, it recently made a comprehensive analysis of the airport requirements of Washington, D. C., which ended with a recommendation to the Congress for a second air commerce airport adjacent to the Capital. Another current study involves the question of an international airport in Canada, across the border from Detroit.

At first, these economic studies were reproduced in limited editions for the use of the CAA staff. Demand for them developed quickly, however, from industry, research organizations, and the teaching profession; as a result, they are now reproduced in quantity and have a wide distribution. The methods employed in these studies are finding their way increasingly into other aspects of air transportation. They are currently being applied to problems of terminal and en route navigational aids. They appear with increasing frequency in briefs presented to and hearings held

before the Civil Aeronautics Board, the regulatory agency in air transportation. The more general of these studies have attracted the attention of market researchers. The *Economic Character of Communities,* for example, was the subject of a paper before the American Marketing Association and the basis of an article in *Sales Management.*

More important than the specific methods, however, is the general approach of the research program discussed above. Its purpose and its effect is toward the most rational allocation and use of resources available for the Federal Aid Airport Program. "This is an unchartered field," wrote a staff member of the Council of Economic Advisors, "in which investments have been made on the basis of optimism and promotion. You have done more to delineate the area in which informed judgment is the only basis for action than I had thought possible. . . ."

Enough has already been said to demonstrate that the approach used has a general applicability to a great many governmental programs involving distribution of public moneys or other public resources. Modification in details will of course be necessary in each case, for obviously criteria must be according to particular programs and specific facilities involved. But the basic approach — that of formulating economic criteria of community needs, of analyzing community requirements and of establishing facility priorities accordingly — will obviously work as well in other fields of aviation as in airports, in other fields of transportation as in aviation, and in a great many other areas — for example, television broadcasting facilities — as in transportation.

Canada's Economic Position

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ANADA'S ECONOMIC PROBLEMS are in ome ways the same as those facing the Jnited Kingdom and the countries of Vestern Europe; in other respects, they re different.

As in the United Kingdom and the ountries of Western Europe, Canada's roblems are partly the result of her inustrial development. Since the time of he founding of the nation, the couny's whole economic policy has been ne of trying to build up industrially. ike all countries embarking upon such n economic policy, Canada has had to epend upon outside help for her rowth. Her dependence upon outside elp has vacillated between the United tates and England and, to a certain xtent, Western Europe.

As a result of World War I, Canada ound she could receive less and less of his kind of help from the United Kingom and the countries of Western Euope, as the United States became the reditor of these nations. However, she ill depended on these nations to help alance her payments with the United tates. World War II not only brought a climax the inability of the United ingdom and Western Europe to lend nd invest money in Canada, but made practically impossible for these counies to receive the goods and services om her, as they could no longer pay r them. Therefore, Canada was laced in a position not unlike that of urope in relationship to the United tates.

Canada, like Western Europe, has become partially dependent on United States lending and investment. She has found herself tied to the necessity of a continuous inflow of American capital into her boundaries. However, that inflow has always been subject to its own fluctuations, resulting in a tendency toward instability.

Furthermore, but to a less serious degree, Canada has been faced with an apparent prospect of a lack of gold and United States dollars. She has received some aid from this country in the form of loans from the Export-Import Bank, and part of the European Recovery Program offshore purchases on United Kingdom account have been spent in Canada. In addition, she has given aid to Western Europe in excess of the amount she has received from the United States.

Like Western Europe, Canada has an economic fear of the United States. On the other hand, however, she has natural resources that will enable her to compete over long periods of time with American industry. However, Canada fears that as her industry develops and becomes more competitive with American industry she will become more dependent on American markets. She is afraid that the instability of the American economy, as illustrated by the 1949 recession, will affect her economy as well. J. Douglas Gibson, Economist of the Bank of Nova Scotia, writing in *Canada's Economy in a Changing World,* perhaps best summarizes this when he says:

From bitter experience we are inclined to regard the United States economy as unstable and United States purchases from us as even more variable. Yet we must turn increasingly towards that market.

The sections that follow are an attempt to show Canada's economic position in relation to the United States, to the United Kingdom, and to Western Europe.

Canada's Part in the Atlantic Trade Triangle

Canada's part in the Atlantic Trade Triangle, involving primarily the countries of Canada, the United States, and the United Kingdom, has always been more or less dependent upon her ability to balance her payments with the United States by the excessive amounts and quantities of goods and services she shipped to the United Kingdom and, to a lesser degree, to the countries of Western Europe and the members of the sterling area.

Before World War II Canada had a deficit in her balance of payments to the United States and a surplus in her balance of payments to the United Kingdom. In 1937 her balance-of-payments deficit with the United States amounted to $37 million, whereas in the same year her balance-of-payments surplus with the United Kingdom was $237 million. The United Kingdom's so-called unfavorable balance of payments with Canada was counterbalanced by the former's trade transactions with the countries of the sterling area, which were heavy net exporters to North America.

The traditional pattern of the Atlantic Trade Triangle no longer exists. The circumstances resulting from World War I, when the United States became a creditor nation; the "hard times" of the 1920's and 1930's; and World War II have changed the trading relations among Canada, the United States, and the United Kingdom. The United Kingdom and other members of the sterling area, in order to keep their economies going, have become heavily indebted to the Dominion of Canada and to the United States. The members of the sterling area, rather than having export surpluses with the United States, have been importing more American goods into their countries than formerly. In 1947, Canada had an American imbalance of payments of $299 million, and so-called favorable balances of payments of $387 million with the United Kingdom and $491 million with the countries of the sterling area. Neither the United Kingdom nor the other members of the sterling area, in spite of their indebtedness to Canada, have been able to help Canada balance her payments with the United States. E. R. P. off-shore purchases in Canada on United Kingdom account have helped somewhat, but not to the extent necessary to bring about a better trading balance between Canada and the United States.

In mid-December, 1947, Canada's official holdings of United States dollars and gold reached an alarming low of $461,000,000, as compared with holdings of $1,508,000,000 in December, 1945. Therefore, the Dominion decided to rely less on American imports and more on getting her imports from countries, like the United Kingdom and the other members of the sterling area, with which she had a "favorable" balance of payments. On November 17,

947, Canada enacted the Emergency xchange Control Conservation Act in n attempt to correct the imbalance of ade with the United States and to ve dwindling supplies of United tates dollars and gold. Import restricons were placed upon both consumer nd capital goods. Travel expenditures y Canadians in the United States were stricted, and drawings on foreign ans granted by the Canadian governent were reduced. At the end of 1949, s a result of the policy of diverting nports and the Emergency Exchange ontrol Conservation Act of 1947, gold nd dollar reserves were $1.3 billion.

In trying to discourage American imorts by the use of import controls and ther devices, Canada has found the roblem to be most difficult because of e needs of her industrialization proram. Many of the products she needs ome only from the United States. In 948, the first year which tested the alidity of the import controls, Canaian imports from the United States presented 68.5 percent of all imports; 1949, they accounted for 70.8 perent. In December, 1949, trade beveen the United States and Canada alanced at $145 million. In January, 950, Canadian exports to the United tates totalled $128.4 million and imorts from the United States were alued at $127.9 million.

As a result of the more favorable ade position between the two counies, Canada has been slowly relaxing er import controls. On October 1, 949, she suspended all import restricons on fresh fruits and vegetables in eir natural state and also on fruit ices. Many import controls have been anged from the prohibition list to the quota list. A few controls were relaxed on April 1, and many others on July 1, 1950.

Both C. D. Howe, Canadian Trade Minister, and Harold Wilson, President of the British Board of Trade, have stated that the re-establishment of the North Atlantic Trade Triangle is essential not only for their own trade, but for the trade of the world. However, both Canada and the United Kingdom believe that America must play a leading part in trying to bring about the restoration of the Atlantic Trade Triangle by increasing this country's purchases of the goods and services of the Dominion, of the United Kingdom, and of the countries of the world.

The Third Canadian International Trade Fair

Speaking at the ceremonies of the opening of the Second Canadian International Trade Fair, at Toronto, on May 30, 1949, Charles Sawyer, U. S. Secretary of Commerce, said, "The people of Canada have created something new in the Americas. Until last year, there had never been an international trade fair in the Western Hemisphere."

Since making the International Trade Fair from 1948 on an annual affair, Canada has made it her business to play host to the commerce of nations. By the use of the Fair as a medium she can and does do her part in trying to promote international economic cooperation and in helping to re-establish multilateral trade among the nations of the world.

Manufacturers from all parts of the globe have shown their wares at the Toronto exhibition grounds and have

found new markets there. In 1950 overseas manufacturers had hopes of finding new sources of acquiring much-needed dollars. In 1948, about 40 percent of the exhibitors came from abroad; in 1949, 60 percent; and in 1950, about 80 percent. Among the exhibitors at the 1950 Fair, the British manufacturers, with the British Tool, Machine Tool, and Scientific Instrument Association in the forefront, predominated in the amount of floor space allotted and equipment shown. A few Eastern European countries, including Czechoslovakia and Yugoslavia, exhibited their products in 1950. In 1949, the Czechs called the Fair, "An immediate commercial success." In that year the Czechs did $7,000,000 worth of business in Canada, $4,000,000 of which resulted from their participation in the Trade Fair.

Canadian Minerals and Resources

Canadian minerals and resources are exported and used in large quantities each year; not only are they shipped to the United States, but also to the United Kingdom, to Western Europe, and to many other countries. Most important, they also help to meet the needs of Canada's own industry.

Canada is the world's leading producer of asbestos and of platinum metals and one of the foremost producers of nickel. She exports large quantities of bauxite, copper, zinc, silver, and lead. Canada also sends to the United States products that go into the making of the atom bomb, for example, uranium.

Until recently the only known iron ore deposits in Canada were weak in iron content, but newly discovered deposits in northern Quebec and Labrador have led the Canadians, who now depend on foreign imports, to anticipate that they may have iron ore to export. A $200-million program is now under way to begin exploitation of these deposits. Five American companies — Republic, Armco, National Steel, Youngstown Sheet & Tube, and Wheeling — are interested in the Labrador deposits partly because the high-grade ore of the vast Mesabi range may be depleted in about ten years' time.

One of the richest titaniferous ore deposits in the world has been discovered in Quebec. Titaniferous ore makes possible a product that is stronger than steel and lighter than aluminum. A $25-million project is being planned for the next two years by Kennecott Copper and New Jersey Zinc to develop Allard Lake's ilmenite reserve of 200 million tons.

Huge oil reserves have been found in western Canada that will make the country less dependent on foreign oil imports. Canadians have had to import oil at the rate of about 200,000 barrels daily, with one-quarter of that amount coming from this country. Sales of United States oil in Canada have already begun to fall off. Two years ago such sales amounted to about $16.7 million monthly, and as of last December sales were $10 million. It is expected that within five years sales will become negligible.

It is estimated that from the oil fields of Alberta alone, within a few years, 300,000 barrels will be turned out daily. As the oil of the prairie provinces is located about 1,600 miles from the industrial section of eastern Canada, the problem will be one of getting it to

market. Plans are in prospect to build pipelines to make possible the piping of oil to the United States and to eastern Canada. One such line, to be completed at the end of this year, will begin about 30 miles northeast of Edmonton, and will enter the United States at Neche, North Dakota, and be extended to Superior, Wisconsin. This line will cover 1,180 miles and will cost $92,000,000.

Besides oil, natural gas is found in Canada. The residents of Seattle, Spokane, Vancouver, and Portland, in the United States Pacific Northwest, are interested in getting this natural gas piped into their cities. Estimates indicate that more than $3,000,000,000 will be required to finance the growing Canadian oil and gas companies in the next five years.

Water to be harnessed and used to generate power is plentiful in Canada. The Ontario Hydro Commission is increasing the number and horsepower capacity of its steam power plants in some of the larger cities of the province of Ontario in order to meet power requirements created by growing industrialization. The Commission is in the process of increasing the facilities by building a 206,000-horsepower, $40,000,000 steam power plant at Toronto and another of 160,000 horsepower at Windsor, and is contemplating building one at Hamilton.

The Growth of Canadian Industry

Canada has been depending less and less on the United States and England to ship many of the consumer and industrial products her people want, as her own industry replaces "foreign-made" products. Since the war more than 4,000 manufacturers have invested $2 billion in 10,000 projects. In 1948 more than 200 products formerly imported from abroad were produced in Canada. In that year Canadians had a wider choice of domestically produced consumer goods than in any previous year. The country no longer relies on the United States for articles like household appliances, trucks, buses, Diesel engines, a number of machine tools, electric generators, combines, tractors, and industrial chemicals. Domestically made textiles, such as cotton goods, woolens, and worsteds, sell at cheaper prices than the imported American or British products.

Canada has been gaining ground in making her own steel. Foundry, casting, forging, and rolling mill facilities have been greatly enlarged. Steel production has increased considerably in the period from 1939 to 1949; in 1939, Canada produced about 129,000 tons and in 1949, about 266,000 tons. Under normal conditions Canada imports between 700,000 and 1,000,000 tons of steel a year, the larger proportion coming from the United States. However, in 1949, she imported about 1,500,000 tons of steel, and it is expected that a like quantity will be imported in 1950.

Until last year Canada obtained her stainless-steel sheet from foreign markets, receiving over 90 percent, or 2,500 tons, from the United States alone. Atlas Steels, Ltd., at its works in Welland, Ontario, has started to install the country's first stainless-steel-sheet rolling mills.

The chemical industry of Canada plays a large part in industrial development and is expanding rapidly as a result of the demand of the war years.

The industry produces heavy chemicals, raw materials for the plastics industry, and a large variety of organic chemicals.

It is generally believed that the real reason for Canada's imposition of import controls on a number of goods in 1947 (import controls that have only recently begun to be relaxed) was not to save needed United States dollars, but to protect her "infant" industries. The import controls were put on many durable-goods items in which a considerable part of the capital investment in Canada is taking place. Canadian Trade Minister Howe, writing in *Industrial Canada,* stated in explaining the import control restrictions that those on capital goods would be administered with a view to the ultimate expansion of Canadian industry by giving high priority to industrial projects, especially to those products which would be selling for United States dollars.

Great Britain's Role in Canada

Partly as a result of fear of American economic instability and partly because of the prospect of a lack of gold and United States dollars, Canada has been helping and encouraging the British to expand their economic position in the Canadian market.

Harold Wilson has stated that Britain could increase tenfold its exports to Canada. This statement by the President of the British Board of Trade has even greater meaning, since British goods have an advantage over United States goods in the Canadian markets as a result of the devaluation of both the Canadian dollar and the pound sterling. Hundreds of British firms have sent representatives to Canada to look into markets for British investment possibilities. For instance, some British firms representing electrical and machine-tool industries sent a six-man team to Canada. The technical director of Ransomes & Rapier, Ltd., manufacturers of heavy construction equipment, arrived in Canada recently to look over the idea of setting up a subsidiary. A group of British Diesel-engine producers have formed a Canadian sales subsidiary, Brush (Canada) Ltd., and the Federation of British Industries has sent a representative to Canada. Trade missions, like the British Steel Mission and the British Agricultural Mission, have also visited Canada. The British have another advantage in the Canadian markets in that the Ottawa Agreements of 1932 are still in effect.

Canada has set up as a business organization the Dollar-Sterling Trade Board, headed by James S. Duncan, President of Massey-Harris Co., manufacturers of farm machinery. The Board, supported by the Canadian Trade Minister, has as one of its aims increased Canadian purchases of British products so that Britain can continue to buy in Canada. In an attempt to increase sales to Canada, a number of British industrialists have established a Dollar-Export Board, under the chairmanship of Sir Charles Weir.

Although there already are a number of British subsidiaries in Canada, many more British companies are contemplating setting up branch establishments. They hope not only to market their products in Canada but to use that country as a base from which they can sell products to the United States.

The British steel industry hopes to send 160,000 tons of steel to Canada in 1950. Orders have already been signed

for rails worth $1,850,000 and orders are under negotiation for other steel products that will probably bring British steel sales to $15-20 million.

Since the Canadian-British drive began in Canada, British sales of goods have greatly increased. For example, sales of automobiles have doubled and British Diesel motor sales have tripled.

Canadian Relations with the United States

American industries began "jumping the tariff" about 1900. Today, American companies have over $3 billion invested in branches and affiliated companies in Canada. Last year 180 United States companies established branches or subsidiaries there. Direct investments by this country in Canada represent about 20 percent of the capital invested in all Canadian businesses and about 37 percent of total investment in manufacturing.

United States-controlled concerns in Canada account for high proportions of automobile output, producing about 95 percent of the total, and also for high percentages in rubber products. American-controlled firms also account for two-thirds of all petroleum products manufactured. On the other hand, American establishments account for only low percentages in flour milling and in textiles. United States firms manufacturing pulp and paper accounted for about 29 percent of total production in 1948. American manufacturers of miscellaneous iron and steel products in 1948 produced only 8 percent of the total output.

As Canada's trade policy emphasizing industrialization and development of natural resources continues, she will import less and less consumer goods and more and more capital goods and raw materials from this country.

Iron and steel products and industrial machinery imports to Canada from the United States have risen steadily and are expected to continue their advance in 1950. This country sent over $203 million worth of machinery to Canada in 1948, whereas in 1938 it sent only $31 million. In November, 1947, the Export-Import Bank granted a loan of $300,000,000 to Canada, half of which was to be used for the purchase of American machinery and equipment.

Many American businesses have already felt the impact of Canadian industrialization and many more will do so. In 1947 imports of American soap and toilet preparations were valued at $157,000 a month, dropping to $41,000 a month in 1948. Four-fifths of all refrigerator equipment supply and almost all radio equipment sold in Canada are of domestic manufacture. Other American companies yet to feel the impact of this industrialization are those manufacturing automobiles, automobile parts, most electrical appliances, leather goods, apparel, recreational items, and photographic equipment.

As Canadian industrialization progresses, the composition of Dominion exports to the United States is bound to change from the traditional exports of lumber, newsprint, woodpulp, and paper; nonferrous metals; asbestos; farm products; and fish. Many scarce materials like titaniferous ore and manganese will come from Canada; and, instead of unprocessed products, processed products from the Dominion will appear on the American market.

Nutrition and Agricultural Price Policy

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DURING THE LAST TWO DECADES, the Federal government has engaged in extensive price-supporting operations in agriculture. Among the methods used were purchase and storage of farm products, restriction of output, export dumping, diversion of foodstuffs and fibers to lower uses, gifts to the needy, and destruction of portions of the crop. So far as the Federal government is concerned, the record starts with the purchase and storage programs of the Federal Farm Board[1] under President Hoover; it has not yet ended with the projected destruction of 25 to 40 million bushels of potatoes.[2]

An analysis will be made here of the relationship between government price policy and the nutritional needs and levels of the people in the United States. We shall first survey the national diet. Then, the relationship between government agricultural policy and food consumption will be reviewed. Although government policy in the nonagricultural sphere of the economy has an important bearing on the level of income and its distribution, its impact on food consumption will not be discussed.

The National Diet

How adequate are the diets in the United States? The National Research Council indicated that in 1936 fewer than one-fifth of the families had food supplies that met an adequate diet with respect to seven nutrients studied. About one-fourth of the farm families were in this category, but only one-seventh of the nonfarm families.[3] By 1942, although the situation was greatly improved as a result of higher incomes and nutritional education, one-third of the diets still failed to meet the National Research Council standards in one or more nutrients.[4]

The Council probably overstates the case. Not all families that received less than the recommended nutrients were malnourished in the usual sense of that term. The proposed standards of the Council are aimed at preventing deficiency diseases that can be detected only by medical or clinical tests, with liberal additions to provide a margin

[1] The Federal Farm Board also preached restriction of output and destruction of crops, but it had no practical means to implement its plans. When farmers failed to reduce cotton plantings, Federal Farm Board officials proposed that one-third of the cotton crop be plowed under—without compensation to the farmers.

[2] *New York Herald Tribune*, February 4, 1950, p. 1.

Here Secretary of Agriculture Brannan is quoted as saying that, technically, he did not consider the special disposal program as dumping, since the potatoes remain on the farm for secondary or inferior use. "We will not tolerate destruction. Farmers and dealers from whom we acquire these surpluses will be required to buy them back at one cent a 100 pounds and guarantee disposal will be as feed, fertilizer, or field freezing for spring use as feed."

[3] National Research Council, *Inadequate Diets and Nutritional Deficiencies in the United States*, Bulletin No. 109 (Washington, D. C., 1943), p. 3.

[4] L. A. Maynard, "Deficiencies in the United States Diet, and Means of Meeting Them," *Journal of Farm Economics*, Vol. 29, No. 1, p. 320 (February, 1947).

of safety. Extra nutrients are required to overcome deficiency diseases which already exist, and they are necessary during illness and convalescence or at times when the body is under extreme strain. The food allowances recommended by the National Research Council are therefore an ideal to aim for rather than a minimum below which people are deemed to suffer from malnutrition.[5]

An indication of the inadequacy of the diets of a considerable section of our population is revealed by the Selective Service rejection rate during World War II. From November, 1940, to August, 1945, of 17,954,500 men in the prime of life who were examined, 35.8 percent were rejected.[6] Clinton P. Anderson, then Secretary of Agriculture, estimated that one-third of the rejected men were "physically deficient because of ailments, such as deforming rickets, which traced to inadequate nutrition."[7] In other words, 12 percent of all young men called up for service were incapable of performing even limited military duties because they had not had adequate diets. A remedy was suggested: "It would help the progress of the war if the trainees could be properly fed for a few months before being inducted."[8]

Why Are Diets Inadequate?

Undoubtedly several factors contribute to deficient diets: unwise buying of foods, ignorance concerning well-balanced diets, destruction of vitamins in cooking, wasting food in the kitchen. However, inadequate purchasing power must rank high on the list of causative factors. Many studies point to the fact that diets tend to become more adequate as we move upward on the income scale. Ernst Engel's law of almost a hundred years ago has been proved correct: the higher the income, the smaller the percentage spent on food; the lower the income, the larger the percentage spent on food. People try to satisfy their craving for food by reducing other expenditures. For example, in the spring of 1942, urban families with incomes up to $499 spent 65 percent of their incomes on food. As incomes increased, the percentage spent on food declined. Urban families making over $3,000 a year spent only 17 percent of their incomes on food.[9]

Another study of family expenditures (both urban and rural) indicated that in 1941 families with incomes under $500 a year spent 49.7 percent of their incomes for food; the $500-$1,000 income group spent 36.9 percent on food; and the $1,000-$1,500 group spent 32.4 percent on food. As incomes increased, the percentage spent on food declined; the $5,000-or-over group spent only 12.0 percent on food.[10]

In 1936, among those families with

[5] See J. D. Black and M. E. Kiefer, *Future Food and Agricultural Policy* (New York: McGraw-Hill Book Company, Inc., 1948), pp. 27-28.

[6] *New York Herald Tribune,* November 1, 1948, p. 1.

[7] "Is the Farmer Heading for Trouble Again?" *Saturday Evening Post,* Vol. 218, No. 25, p. 95 (December 22, 1945).

[8] J. D. Black, "The Social Milieu of Malnutrition," *Annals of the American Academy of Political and Social Science,* Vol. 225, p. 148 (January, 1943).

[9] U.S.D.A., *Family Food Consumption in the United States, Spring 1942*. Misc. Publ. No. 550 (Washington, D. C.: Government Printing Office, 1944), p. 35.

[10] J. F. Dewhurst *et al., America's Needs and Resources* (New York: Twentieth Century Fund, 1947), p. 98.

an average expenditure of $1.75 per person per week for food, 73 percent living in the North and West had "poor" diets; 27 percent had "fair" diets; none had diets graded as "good." Of those whose expenditures averaged $4.50, only 3 percent had poor diets and 69 percent had good diets.[11]

Other investigations indicate that fluid milk consumption declined as much as 25 percent in some industrial cities which suffered great unemployment during the nineteen thirties, and the average decline for all cities studied was nearly 12 percent.[12] In the 1936 survey of urban diets, it was found that the consumption of fluid milk was 84 quarts per capita per year in the lowest income bracket and 242 quarts in the highest income bracket.[13]

In the winter of 1940-1941, 500 pupils from a New York City high school in a low-income area were examined. A high-income group of 350 pupils in a private school in the same city were then studied by the same methods. Of the low-income children, only 4 percent were free from all deficiencies with respect to vitamins A and C, riboflavin, and iron. Seventy-six percent showed at least a mild riboflavin deficiency, and 50 percent some degree of vitamin C deficiency. In the high-income group, on the other hand, only 2 percent showed deficiencies in riboflavin, and 6 percent in vitamin C.[14]

In the spring of 1942, while urban families in the $0-$499 group consumed 2.86 quarts of milk per person per week, those in the $3,000-or-over group consumed 4.04 quarts per person. The highest income group consumed 17 percent less potatoes per capita than the lowest group; 50 percent less peas, beans, and nuts; 36 percent more green and yellow vegetables; 125 percent more tomatoes and citrus fruits; 39 percent more of other vegetables and fruit; 96 percent more meat, poultry, and fish; and 28 percent more eggs.[15]

According to Clinton P. Anderson,

> Families with less than $500 a year eat only 1,000 pounds of food per person annually — and they must depend on the cheap, hard-to-balance foods. Families with $5,000 or more a year buy about a ton of groceries per individual — and automatically enrich and balance their diet with more meat, fruits, dairy products and vegetables, insuring plenty of minerals and vitamins.[16]

The evidence seems to be conclusive that: (1) Large sections of the population in the United States have less than adequate diets. (2) One of the important causes of inadequate diets (although by no means the only cause) is lack of purchasing power.

Nutrition and Government Policy

To the extent that the government supported farm prices, restricted out-

[11] U.S.D.A., *Family Food Consumption and Dietary Levels, Five Regions.* Misc. Publ. No. 452 (1941), p. 57.

[12] J. D. Black, *The Dairy Industry and the AAA* (Washington: Brookings Institution, 1935), p. 79.

[13] P. L. Yates, "Food and Income," in T. W. Schultz (ed.) *Food for the World* (Chicago: University of Chicago Press, 1945), p. 177.

[14] Black, "The Social Milieu of Malnutrition," *loc. cit.*, pp. 148-149.

[15] *Family Food Consumption in the United States, Spring 1942*, p. 7.

[16] "Is the Farmer Heading for Trouble Again?" *loc. cit.*

put, and destroyed food or diverted it to non-human or lower-grade uses, it interfered with good nutrition. The New Deal Administration doffed its hat, tongue in cheek, to the consumer interest in the Agricultural Adjustment Act of 1933. The Act pledged

> to protect the consumers' interest by readjusting farm production at such a level as will not increase the percentage of the consumers' retail expenditures for agricultural commodities, or products derived therefrom, which is returned to the farmer, above the percentage which was returned to the farmer in the prewar period August 1909-July 1914.

This stipulation seems to protect the consumer, since the higher the prices of farm products, the larger the proportion which goes to the farmer; merchants' and processors' margins tend to remain fixed when measured in dollars per unit of their output. Setting a ceiling on the percentage of the consumer's dollar which the farmer may receive seems to set a reasonable ceiling on retail prices. But such is not the case. The farmer's share fell by 1932, not only because of the decline in prices of farm commodities, but also because farm products go through more processing than they did before the first World War.

Possibly the further growth of big business in food processing and distributing resulted in further cuts in the farmer's share of the consumer's expenditure on food. C. J. Brand, Coadministrator of the Agricultural Adjustment Act, stated that "on the average retail food prices in 1932 were 10 percent higher than they were in 1910; farm prices were 40 percent lower."[17] To force farm prices up to the point where farmers would receive the same percentage of retail sales as they did in 1910 would mean that food prices would have to rise 46 percent above the 1932 level.[18] The consumer's interest was not safeguarded by such legislation.

The Hog-Slaughtering Campaigns

The earliest price-raising and crop-destroying program was undertaken in the emergency pig-sow slaughter campaign in 1933. Some of the slaughtered swine were distributed to people on relief, but most were wasted. When hogs fell to $3.36 per 100 pounds, the emergency slaughtering campaign was started to remedy the situation.[19]

Growers were offered from $6 to $9.50 per 100 pounds for young pigs, and a bonus of $4 per head in addition to the regular prices for sows. Between August 23 and September 29, 1933, 222,149 sows and 6,188,717 pigs were delivered for slaughter. The sows, and pigs weighing over 80 pounds, were converted into edible products and dis-

[17] Quoted in E. G. Nourse, *Marketing Agreements Under the AAA* (Washington: Brookings Institution, 1935), p. 39, footnote.

[18] The assumption is that any increase in retail prices would be received by the farmer. The calculation is based on the fact that in 1932 the farmer received 32 cents of the consumer's food dollar (*Agricultural Statistics, 1948,* p. 582). If any part of the retail price increase did not go to the farmer, then prices could rise more than 46 percent under the Act of 1933.

[19] The following section is based on J. S. Davis, "Planned Agricultural Adjustment in the United States, 1933-1934," in W. L. Holland (ed.), *Commodity Control in the Pacific Area* (Stanford University, California: Stanford University Press, 1935), pp. 57-58.

tributed for relief. Fifty thousand tons of edible salt meat were turned over to the Federal Emergency Relief Administration and distributed by February 1, 1934. The light pigs (25 to 80 pounds), which made up 82.5 percent of the total number, and which aggregated well over 100,000 tons live weight, were rendered for inedible grease and the residue turned into fertilizer tankage.[20] The net cost of the hog-slaughtering campaign was about $32 million.

The second emergency measure used to support hog prices until production could be reduced was the purchase, between November, 1933, and September, 1934, of 3 million hogs for distribution in processed form to families on relief. These purchases were jointly undertaken and financed by the Agricultural Adjustment Administration and the Federal Surplus Relief Corporation. Unlike the purchases made during the earlier campaign, these relief purchases were planned to obtain hog products for those in need as well as to increase hog producers' incomes. About 150,000 tons of hog products were distributed in this program.[21]

Marketing Agreement and Order Programs

The marketing agreements provision of the Agricultural Adjustment Act of 1933 provided a powerful weapon for the destruction and diversion of farm products. The Agricultural Marketing Agreement Act of 1937 reenacted, amended, and supplemented the provisions of the 1933 Act. The legislation alone imposes no control over the marketing of any commodity. It is enabling legislation, under which programs may be undertaken with respect to specified commodities. In 1949, programs were in effect for milk, and for certain tree fruits, nuts, and vegetables.

A marketing agreement is a voluntary contract between the Secretary of Agriculture and one or more of the grower, distributor, and processor groups interested in a particular commodity. Usually the Secretary will enter into a marketing agreement only after 50 percent or more of the handlers of the commodity sign the agreement.

Those handlers who do not choose to participate in the agreement are usually compelled to do so. If two-thirds or more of the producers approve the issuance of an order, the Secretary may then issue the order making the terms of the marketing agreement program binding upon the entire industry in a specified area. Even if the majority of the handlers oppose the order, it can be issued and enforced if the required number of producers of the commodity in question favor it. Controlling all the handlers brings into line the minority of producers who do not wish to enter into contracts with the Secretary.

Most programs for fluid milk markets are in effect under orders without agreements, whereas most programs for other commodities are under both marketing agreements and orders. Milk marketing orders establish minimum producer prices according to the use made of the milk by the handlers. For

[20] The 100,000-ton figure is an estimate of the writer, assuming that the average weight per pig was 40 pounds. If we assume that the average weight was the mean between 25 and 80 pounds, then over 134,000 tons (live weight) of pigs was diverted into non-food channels.

[21] Davis, *loc. cit.*, pp. 61-62.

commodities other than milk, marketing agreements and orders may regulate the industry along the following lines:

(1) Regulation of quality by specifying which grades and sizes may be shipped to market and which must be withheld. Shipments of inferior grades and small sizes may be prohibited during an entire marketing season.

(2) Regulation of quantity that may be shipped. The permissible quantity is allocated among all handlers on the basis of past performance of handlers or the amount of product each handler has available for current shipment. All shipments may be prohibited during market gluts.

(3) Reserve pools of the commodity may be established. Part of the crop is withheld from the market unless prices remain above certain specified levels. If the market can absorb additional stocks at specified prices, the commodity is slowly released for sale. If not, it is permanently diverted from the usual channels of trade.

(4) Determining the proportion of the crop which is surplus and diverting it from the normal channels of trade. Surpluses may be diverted to lower-grade uses for humans (as peanuts for oil), to livestock feed, or to the export trade.

(5) Prohibition of unfair methods of competition and unfair trade practices in the handling of commodities. Handlers can be prohibited from granting price concessions or rebates to retailers.

(6) Open price posting. Handlers must file their selling prices, and they may not sell at prices lower than those posted. They may change their prices if adequate notice is given.[22]

Some examples of diversion and destruction of foodstuffs under the marketing agreement and order program will be cited here. The second marketing agreement ever signed went into effect in August, 1933. It restricted the 1933 pack of California cling peaches to 10 million cases. Canners representing 20 percent of the industry who refused to sign were forced into the program. All canning peaches below No. 1 grade and some of the No. 1's were allowed to rot in the orchards. Growers received $20 per ton for all No. 1's canned, and $15 per ton from the AAA for all No. 1's which were not used. The difference represented harvesting costs. No payments were made for inferior grades. A new peach agreement was reached in 1934, but the plan was abandoned in 1935 because pear packers were promoting sales at the expense of canned peaches. Charges were also made that overplanting of peach trees occurred because of the peach agreement, but opinion was divided on this point.[23]

In 1934, under the peanut program, 75,000 tons of peanuts were diverted from normal trade channels into the manufacture of peanut oil or into feed for livestock.

A marketing order issued by the Secretary of Agriculture in 1936 declared the walnut surplus to be 25 percent. The surplus was delivered to a Control

[22] See U.S.D.A., Production and Marketing Administration, *Price Programs of the United States Department of Agriculture, 1949*. Misc. Publ. No. 683 (1949), pp. 33-38.

[23] Nourse, *op. cit.*, pp. 165-173.

Board for export. Orders in subsequent years declared the walnut surplus to be as high as 40 percent, and in each case the surplus had to be delivered for diversion from the usual channels of trade. Similar diversion programs were adopted for dried fruit and ripe olives.

An order issued in 1937 dealt with potatoes grown in Michigan, Wisconsin, Minnesota, and in certain counties of North Dakota. It prohibited handlers from shipping in interstate or foreign commerce potatoes which did not at least meet the requirements of U.S. No. 2, or were less than 1½ inches in diameter. A similar order was issued in 1938 for certain varieties of pears grown in the Western states. Marketing orders were issued limiting or prohibiting shipment of certain qualities and sizes of onions, citrus fruits, melons, grapes, fresh prunes, peaches, strawberries, and tomatoes. At various times shipments of even top-grade Florida celery, hops from the Northwest, and California plums and pears were limited and prorated among growers. Once when the quota for canning asparagus was filled, cutting stopped and the plants were allowed to go to seed.

To discover the extent of postwar diversion and destruction of foodstuffs, the writer has examined all issues of the *Federal Register* for July, 1949. Marketing agreements and orders of the Production and Marketing Administration of the Department of Agriculture are published therein. The following orders were issued and agreements proposed:

Fresh plums could not be shipped between July 23 and November 1 or December 1, 1949 (depending on the variety), unless they were U.S. No. 1 and not below a certain size. Each shipment of plums had to be inspected by a representative of the Federal-State Inspection Service to see that the shipper complied with the marketing agreement and order.

A marketing agreement and order (subject to referendum among growers of prune plums) provided that a portion of the California prune crop should be declared as surplus. Surplus prunes (even of the best quality) could be sold to the United States government, or for animal feed, distillation, or export if the foreign demand were larger than estimated and allowed for. Starting in 1949, a Prune Administrative Committee representing producers and handlers was to recommend to the Secretary of Agriculture a salable percentage and a surplus percentage.[24]

From July 10 to September 12, 1949, no fresh peas could be shipped from 4 counties in Colorado unless they were U.S. No. 1 and the pods at least 3 inches long. Only U.S. No. 1 cauliflower grown in 4 Colorado counties could be shipped between July 21 and August 1.

Hops grown in four states were to be handled under the direction of a Control Board, which could recommend to the Secretary of Agriculture minimum standards of quality and the salable quantity of hops to be marketed.

Between July 3 and December 1, 1949, Bartlett pears grown in California could be shipped only if they

[24] After July, the marketing agreement and order went into effect; 25 percent of last season's California dried prune crop was thus ordered withheld from the market. See *New York Herald Tribune,* September 15, 1949, p. 18.

were of at least a certain size and grade. All shipments were to be inspected for compliance with the order.

Irish potatoes grown in certain counties in Idaho and Oregon could be shipped between July 18 and September 15 only if they were at least 2 inches in diameter or 4 ounces in weight. Potatoes shipped out of Colorado and the Southeastern states for domestic consumption must be at least U.S. No. 2 and 1½ inches in diameter.

To limit the movement of fresh oranges, California and Arizona were divided into three prorate districts. Marketing orders issued during July covered the five-week period July 3-August 7, 1949. During this time, oranges other than Valencias were barred completely from shipment. (They could be bought for canning.) Valencias could be shipped in unlimited quantities from the first prorate district; between 1,200 and 1,300 carloads were allowed out each week from the second district, this quantity being prorated among 155 orange handlers; from the third district, Valencia oranges could be shipped out in unlimited quantities during one week, but they were barred from shipment during the other four weeks.

A proposed marketing agreement and order would regulate the handling of filberts in Oregon and Washington. The Secretary would declare salable and surplus percentages of merchantable filberts each year. The proposal was that the surplus percentage for the fiscal year starting August 1, 1949, be 20 percent.[25]

A proposed marketing agreement and order covering pecans grown in five states would prohibit the handling of small and low-grade pecans.

It was proposed that shipment of Irish potatoes grown in Washington should be regulated.

A marketing agreement and order (subject to ratification by growers) was proposed to regulate the sale of raisins from California raisin grapes. The tonnage produced would be divided into free tonnage, which could be marketed without restriction; reserve tonnage, which could be sold late in the marketing season for not less than the average price for free tonnage; and surplus tonnage, which would be disposed of by sale, gift, or otherwise, as the Raisin Administrative Committee saw fit.[26]

These marketing agreements and orders issued or proposed during July, 1949, indicate that the government is prepared to divert and destroy food on a grand scale.[27] Since small or second-grade fruits and vegetables can be just as wholesome and nutritious as the top-quality product, this compulsory destruction of food is helping to perpetuate inadequate nutrition. In so far as low-income groups would have bought inferior grades at lower prices, the hardship falls mostly on them. Those who can least afford it bear the greatest

[25] Afterwards, the Department of Agriculture announced a filbert surplus of 3 million pounds; it offered an export subsidy of 5.5 cents per pound. See *New York Herald Tribune*, December 1, 1949, p. 6.

[26] During 1946-1948, the government spent $40 million subsidizing the export of nearly one-third of California's raisin crop. See University of California, College of Agriculture, *California Agriculture*, Vol. 3, No. 7, p. 4 (July, 1949).

[27] France sought other remedies. In July, 1933, the sowing of certain high-yielding varieties of wheat seeds was prohibited.

burden of crop restriction, destruction, and diversion.

Subsidized Consumption Plans[28]

At various times, surplus foods were distributed to persons receiving public assistance, and to children through the school lunch program. The food stamp plan was an interesting experiment. It operated on a small scale from May, 1939, to February, 1943, and it involved an expenditure of $260 million, excluding costs of administration. It had been estimated that persons getting public assistance spent an average of about one dollar a week per person for food, or 5 cents per meal. Such people had the opportunity to buy a minimum of one dollar's worth of orange stamps for each member of the family. They then received half again as many blue stamps free. The orange stamps were used in purchasing any food at any grocery store. Blue stamps could also be spent in any grocery store, but only for foods found to be in surplus by the Secretary of Agriculture. Surplus foods were chiefly dairy and poultry products, meats, fruits, and vegetables. Grocers redeemed the stamps through their banks, wholesalers, or through the Federal Surplus Commodities Corporation, which administered the program.

The relief milk program was started in 1940, and ended in June, 1943. It was a consumer subsidy program aimed at expanding markets for surplus milk. Households receiving public assistance from state and local welfare agencies were certified as eligible to receive milk. Handlers were reimbursed by the Federal government. A total of $6.3 million was spent on this program, exclusive of administrative costs.

In 1935, Congress passed legislation aimed at widening the market for farm products. Section 32, Public Law 320, 74th Congress, still authorizes the Department of Agriculture to channel surplus farm products to useful outlets. Funds are obtained from customs duties; 30 percent of the gross receipts is made available to the Secretary of Agriculture to subsidize exports of agricultural products, encourage domestic consumption, or to re-establish farmers' purchasing power by making payments to them. A wide variety of foods are purchased and made available to school lunch programs, to charitable institutions, and to persons in low-income groups certified by public welfare agencies as eligible for relief. During 1936-1948, $358 million of Section 32 funds was used for the direct distribution of food.

These subsidized consumption plans were aimed at removing surpluses rather than at supplementing diets of people receiving public assistance. The latter result seems to have been a mere by-product of agricultural policy. The small sums spent on these devices, compared with the huge amounts spent on payments to farmers for reducing output, crop storage and diversion, and export subsidies indicate that subsidized consumption was secondary in the minds of policy makers. Those people who were just above the charity level not only received no benefits from subsidized consumption, but they, along with the rest of the community, had

[28] See U.S.D.A., *Agricultural Statistics, 1948*, p. 573, and *Price Programs of the United States Department of Agriculture*, 1949, pp. 27-33.

to pay higher prices for the food they bought.

Other Plans for Destruction, Diversion, and Storage of Food

During the war, poultrymen were guaranteed 90 percent of parity for eggs. Late in 1943 egg prices slipped badly, and desperate measures were taken to support the price. The War Food Administration bought eggs at 27 to 30 cents a dozen, and diverted part of its purchases to school lunches and to driers and freezers. Then it began diverting fresh eggs to animal feed, selling 6 million dozen for that purpose for one-sixth of a cent a dozen. In all, $55 million was lost in buying up 22 percent of the nation's egg production during that time.[29] Since 1943, egg buying has continued.

The Commodity Credit Corporation has acquired huge stocks of farm products by direct purchase and through the granting of nonrecourse loans on stored commodities. At the end of 1949, the CCC owned 73 million pounds of dried eggs — a ten-years supply for the nation — acquired at a cost of $95 million; 170 million pounds of nonfat dry milk solids which had cost about $20.4 million; 475 million pounds of beans, representing an investment of $41.8 million; 50 million pounds of peanuts which cost $8 million; 100 million pounds of butter purchased for $59 million. The CCC owns large quantities of other agricultural commodities, including cheese, prunes, raisins, potatoes, rice, to mention only foodstuffs. Many of these commodities are being offered at reduced prices for export.[30]

Big potato crops during 1946-1948 brought government intervention in the market to maintain prices at the guaranteed support level of 90 percent of parity. By means of purchase, diversion, and destruction of potatoes, and loans on the stored crop, prices were prevented from falling.[31] The total government loss in the potato support program in 1948 alone was $225 million.[32] In 1949, potato prices were supported at 60 percent of parity. The government bought potatoes at over a dollar a bushel, and sold them for cattle feed at one cent per 100 pounds. It is estimated that the potato diversion program would cost $80 to $100 million for the 1949 crop.[33]

In 1948 the Commodity Credit Corporation had contracted to purchase 400 million pounds of potato flour for shipment to Germany, Korea, and Japan. Although the processors paid the CCC 15 to 35 cents a bushel

[29] *New York Times,* June 11, 1944, Sec. I, p. 13; *Business Week,* No. 782, p. 56 (August 26, 1944); and W. W. Wilcox, *The Farmer in the Second World War* (Ames, Iowa: Iowa State College Press, 1947), pp. 152-153.

[30] See *New York Herald Tribune,* January 19, 1950, p. 9, and National City Bank of New York, *Monthly Letter on Economic Conditions and Government Finance,* December, 1949, p. 138.

[31] Some of these potatoes turned up on the black market at lower than the supported market price — a reversal of the wartime black market relationship. To remedy this situation, purple vegetable dye was sprayed on the potatoes to make them unsalable. See *New York Times,* November 6, 1945, p. 21; *ibid.,* March 1, 1947, p. 12.

[32] Statement by Secretary of Agriculture Brannan before the House Committee on Agriculture on April 25, 1949, *Congressional Record,* Vol. 95, No. 79, p. A2863 (May 5, 1949).

[33] *New York Herald Tribune,* February 1, 1950, p. 6.

for potatoes, they sold the potato flour to the government at 7 cents a pound. Wheat millers complained that they could have supplied wheat flour for 5 cents a pound, and that the potato operation would depress wheat prices. They contended that if the original cost of the potatoes were included in the cost of the potato flour, it was costing the government 25 cents per pound.[34]

Destruction of agricultural commodities in order to maintain high prices is often hidden by silence or indifference. Occasionally an unusual case comes to light. An example is the case of fluid milk, the prices of which are fixed by milk marketing orders, under the auspices of the Department of Agriculture. In a news despatch datelined "Manchester, N. H., September 19, 1947," it was stated that

> the common practice of throwing away surplus milk during flush producing periods in this dairy farming area was brought to the attention of a Congressional price investigating sub-committee. . . . The evidence was given against the background of earlier testimony in Boston, the principal market for this area's milk, that many families there were unable to buy enough for their children at the established price of 21 cents a quart. . . . A milk cooperative president and dairy operator . . . testified that the only way to dispose of surplus milk in such peak periods as April, May, and June was to pour it "down the sewer," since there were insufficient facilities for converting it into powder or other manufactured products.[35]

Summary and Conclusions

The demand for farm products is apparently relatively inelastic with respect to price at the farm. That is, the lower the price, the more can be sold, but total receipts to farmers decline; the higher the price, the less is sold, but total receipts increase. If we were concerned only with the economic interests of agriculture, regardless of the effects on the rest of the community, we should support crop restriction, diversion, and destruction in order to maximize farmers' incomes. But such a policy does not coincide with the needs and interests of nonfarm people. Other policies should be sought, policies which help agriculture without throwing too heavy a burden on other groups.

It seems evident that large sections of the population in the United States have less than adequate diets. One of the important causes of inadequate diets is lack of purchasing power. When the government calls for price supports, crop restriction, and the destruction of farm products or their diversion from the usual channels of trade, it interferes with the goal of good nutrition for the entire population. So long as there are groups of people who do not have adequate diets or the means to obtain them, it would be desirable to produce more foodstuffs and permit them to be sold at whatever prices are established in the market. Price flexibility on the downward side would permit consumers to purchase larger quantities of farm products. Allowing small and second-grade fruits and vegetables to reach the market without restrictions would place more food within reach of those who cannot afford the best.

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[34] *Business Week,* No. 993, p. 35 (September 11, 1948).

[35] *New York Times,* September 20, 1947, p. 11.

Why City Workers Live in Agricultural Villages

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AGRICULTURAL VILLAGES came into existence as supply, shipping, and service stations for farmers. Farm population has been declining for some forty years. Paved roads and automobiles enable the farmers to by-pass the villages and transact some of their business in larger towns. This has meant a declining business for the villages, which has led to a surplus of workers or a surplus of houses. Some men who could no longer find employment in the villages found jobs in larger towns and continued to live in their former homes, driving back and forth to work. Some workers in larger towns secured houses and moved into these villages.

The study reported here was undertaken to ascertain to what extent the agricultural villages in East Central Illinois have become residential suburbs of the larger towns; why workers in large towns live in villages; how they like village life; and how the place of employment affects their shopping habits.

It was found that 23 percent of heads of village households work out of town; 48 percent work in their home villages or in villages or on farms near by; and 29 percent are retired. Omitting households of retired persons, one-third of the employed persons in these villages work out of town. In villages situated within 12 miles of a large town (over 10,000 population), 55 percent of the employed heads of households work out of town, principally in the nearest large town. This percentage drops to 29 for villages 12 to 25 miles from large towns, and to 15 for villages 25 miles or more from the large towns. Out-of-town workers from the last group work in widely scattered places. This fact indicates that workers do not like to drive 25 miles to work.

Most villages within 12 miles of large towns have become residential suburbs of the larger towns, whereas villages situated more than 25 miles from a large town have not. Those situated 12 to 25 miles from large towns might be called quasi-suburbs.

The principal reasons why workers from larger towns move to villages have been their inability to find houses in the larger towns; lower rents and other living costs in the villages; the fact that people in the villages are friendlier than those in large towns; and their feeling that the villages are good places in which to live and to raise their children. Most of those working out of town are satisfied with life in the villages, although a considerable portion would move to the larger towns to get closer to their work if they could find houses there.

Before taking up the detailed findings of this survey, let us take a look at the history of the problem.

Historical Background

The Mississippi Valley was settled under a railroad-and-horse geography. The railroads placed their stations four to six miles apart and around these grew up villages which served as supply depots for surrounding farms, as shipping points for farm products, and as service stations (schools, churches, doctors, banks, repair shops) for the population. County seats were established every twenty to thirty miles. Most of them grew into larger trading centers with more stores and stores carrying wider assortments of goods than were available in the small villages. Many of the county seats developed into *primary* trading centers. This system developed with the railroads in the 1850-1890 period in Illinois and continued until the coming of the automobile in the 1920's. Although the automobile came into considerable use in the 1910's, it was not until the 1920's, with the coming of improved roads and more widespread ownership, that it materially changed our rural economy.

A general statement has been made that people do not want to spend more than an hour going to market except on unusual shopping trips. With villages four to six miles apart, most farmers were within four miles of a village trading center and could reach it in an hour with a team and wagon (except at times when the roads were so deep in mud that they were well-nigh impassable). With the coming of the automobile the farmer could travel ten, twenty, thirty, or forty miles in an hour, depending upon conditions of the road and car and parking difficulties. Thus in the early 1920's many students of marketing were saying that the small agricultural villages were doomed; that they were no longer needed. Some village residents disputed this statement and contended that their villages still served a useful purpose.

Introduction

In 1926, the senior writer became interested in this situation and started to gather information on it. This resulted in a bulletin published by the Bureau of Business Research of the University of Illinois in 1928, *The Automobile and the Village Merchant.* That study found that rural population was declining as a result of larger farms and smaller families; and that the sales of village merchants were declining but at a much slower rate than was generally supposed. A second study on this subject, by Robert V. Mitchell, was published by the Bureau in 1939, *Trends in Rural Retailing in Illinois, 1926 to 1938.* This study showed a continued although slow decline in the sales of village stores. A third study of the subject is planned by the Bureau of Economic and Business Research (the name was changed in 1942).

The first study pointed out that traffic could move in both directions on a highway and that the village merchants might be able to pull trade from the larger towns by their lower prices. In the 1938 survey it was found that very few village merchants, except filling stations and restaurants, had been successful in attracting much trade from residents of larger towns. However, although the villages might not attract customers to their stores

from the larger towns, they could and did attract workers in these towns as residents.

In the first study (1926-27), it was found that some families from larger towns were living in near-by villages, attracted by lower rents; and some workmen from these villages were working in the larger towns but continuing to live in their home towns. With the decline of sales in village stores and of services demanded by a smaller rural population (e.g., doctors, bankers, teachers) fewer houses were needed by local workers. Were these houses to be left empty and allowed to fall to ruin? In a few cases that happened. However, one observes in driving through these villages that most of the houses are occupied. Conversation with residents of these villages and with employers in larger towns revealed that many people live in the agricultural villages and work in larger towns. In 1938 businessmen in some villages said that villages near larger towns could survive as residential suburbs, but that those at a distance would have to develop local industries or gradually "dry up." Is this true? Just how far will people drive to work?

The area selected for study lies between Kankakee on the north and Mattoon on the south; and between Bloomington and Decatur on the west and the Indiana state line on the east. This area is approximately 75 x 110 miles and is thought to be representative of much of Illinois.

In many parts of the nation, large numbers of industrial workers have moved to the country and live along the highways. Some of these have gardens or "subsistence" farms. Others do not and apparently moved to the country because of lower-priced land, to erect their own houses free from building restrictions, or because they like the "fresh air and openness" of the country. If our observations are correct there has been less of this in East Central Illinois than in some other regions. Instead there is considerable use of houses in the agricultural villages by people working in the larger towns; in this area the principal larger places are Kankakee, Chanute Field (at Rantoul), Champaign - Urbana, Danville, Bloomington, Decatur, and Mattoon.

The Survey

The territory contains 118 villages which had 1940 populations of between 200 and 2,500. Of these villages, 29 were selected for the sample by giving each a number and selecting numbers at random. This sample was modified in a few instances by omitting a few villages located at considerable distances from other selected villages and substituting villages of similar size located at similar distances from larger towns. This was done to reduce travel distances for the interviewers. Within the villages, interviewers were instructed to call on every second, third, fourth, or fifth household. In case this proportion would not cover the entire village, interviewers were instructed to select territories in different parts of the village. Thus a modified random sample was used.

A somewhat larger proportion of the households were interviewed in the small than in the large villages. If conditions were different in villages of different sizes, this might distort the results, and so some of the questions

were weighted by village populations. Results were changed so little that most of the figures presented here are unweighted by village size.

The 29 villages chosen were divided into three area groups according to their distances from a large town. Area 1 includes 9 villages within twelve miles of a large town. Area 2 includes 13 villages between twelve and twenty-five miles from a large town. Area 3 includes 7 villages twenty-five miles or more from a large town. In all, 940 interviews were made, distributed as follows: Area 1, 244 interviews; Area 2, 432 interviews; and Area 3, 264 interviews.

The survey covered households and not individuals. The word "household" instead of "family" is used in order to follow the changed nomenclature of the Bureau of the Census. As used in this study it is synonymous with the former "family," including one-person families.

The survey was a joint study by the advanced marketing research class of the University of Illinois and the Bureau of Economic and Business Research. The interviewing was done by students working under the immediate supervision of staff members who acted as crew leaders or foremen.

Distribution of Incomes

The percentages of households in each income group for the three groups of households — heads employed out of town, heads employed in town, and heads retired — are shown in Table 1.

It will be noted that those working out of town tend to concentrate somewhat more in the middle or C income group than do those working in town or near by. Somewhat larger proportions of households with heads working in town are found in the A, D, and E income groups. Retired families are mostly in the D and E groups, although 8 percent are in the A and B groups.

Rents Paid. Seventy-nine percent of the village households own their homes and 21 percent rent the dwellings they occupy. Ninety-two percent of the retired group, 77 percent of those employed locally, and 67 percent of those employed out of town own their homes.

The average monthly rental paid by respondents giving the information was

TABLE 1. PERCENTAGE DISTRIBUTION OF HOUSEHOLDS BY INCOME GROUPS

Income Group (yearly basis)	Head of Household		
	Working out of town	Working in town	Retired
A — $7,200 or more	3	6	3
B — $4,200 - $7,199	22	23	5
C — $2,500 - $4,199	57	42	12
D — $1,300 - $2,499	15	24	25
E — less than $1,300	3	5	55

$31.42. The most common figure was $40 a month, with $30 next. Other typical figures were: $15, $25, $35, and $50. Eighty-two percent of those reporting paid from $15 to $50 a month. Twelve percent paid less than $15 and 6 percent paid more than $50.

Where Village Residents Work

Twenty-three percent of the heads of village households work out of town; 48 percent work in town, or at a nearby village or farm; and 29 percent are retired, pensioned, on relief, unemployed, or odd-job workers. Those in the third group will hereafter be referred to as retired.

The proportion of people working out of town varies greatly with the distance from a larger town. In Area 1, 42 percent of household heads work out of town; in Area 2 this percentage drops to 20; and in Area 3 to 10. The following tabulation summarizes, in percentages, the information as to where heads of households work.

	Area			*Average*
	1	*2*	*3*	
Works out of town	42	20	10	23
Works in home town or near by	34	50	59	48
Retired	24	30	31	29

Omitting the retired group, and considering only those households where the heads are employed, it is found that almost one-third of these employed persons work out of town and two-thirds in their home towns or near by. In Area 1, 55 percent of employed heads of households work out of town; in Area 2, 29 percent; and in Area 3, 14 percent. The sample in Area 3 included 7 villages. Three of these had 1940 populations between 1,000 and 2,500, and 4 had populations of less than 1,000. In the 3 larger villages 13 percent of the employed heads of households, and in the 4 smaller villages 18 percent, worked out of town.

In Area 1, most of the out-of-town workers (92 percent) work in the nearest large town. In Area 2, this percentage drops to 50; and in Area 3 to 17. Some out-of-town workers work in other states and even in foreign countries, but the majority of those who do not work in the nearest large town work in smaller towns closer to their homes.

These figures refer only to heads of households. Eleven percent of the households whose heads are employed out of town reported other members of the household also working out of town. Additional members of 10 percent of the households whose head is employed locally work out of town. In 6 percent of the households where the head is not employed other members work out of town. As the total number of employed persons in these households is not known, no definite figure can be given as to the total proportion of employed persons working out of town. However, it may be somewhat more than one-third. In villages within 12 miles of a primary trading-industrial center, probably three-fifths of the employed persons work out of town.

It appears that villages within 12 miles of industrial-trading centers are primarily suburbs of the larger towns. The proportion of people working out of town decreases beyond 12 miles, and there appears to be a strong resistance to driving 25 or more miles to work.

Kind of Work Done by Persons Employed Out of Town

Most of the persons employed out of town are skilled workers, unskilled workers, and business and professional men. Skilled workers easily lead in number. Skilled and unskilled workers constitute 63 percent of out-of-town workers. Business and professional men make up 15 percent of the total. The other 22 percent are engaged in a great variety of occupations. These proportions do not vary greatly among the 3 areas, with the exception that most of the military employees at Chanute Field interviewed lived within 12 miles of the Field. The following tabulation presents the percentage distribution of out-of-town workers by type of work.

Type of work	*Percentage of workers*
Skilled	41
Unskilled	22
Business and professional	15
Truck and bus drivers	6
Army	6
Clerical	4
Salesmen	4
Government	2

Retired Families

It is well known that a considerable number of people living in the small towns and villages are retired. In the households surveyed, 29 percent are in this group. Many of these are one-person households. Of the total in this group 72 percent reported the head of the household as "retired," 23 percent as pensioned, 4 percent as doing odd jobs, and 1 percent as on relief. Probably many of those classifying themselves as "retired" are on relief. There is very little variation in the proportions of households in these classifications for the three areas.

Why Out-of-Town Workers Live in Villages

The second object of the survey was to learn why persons working in other towns live in the villages. They may be people who had lived in these villages and who, when they were unable to find work or to find jobs at satisfactory wages there, obtained jobs elsewhere and continued to live in their established homes. On the other hand, they may be persons who work in larger towns and live in smaller towns either because they are unable to find houses in the towns where they work or because they prefer living in a smaller town. People may prefer to live in villages for several reasons: rents may be lower; other living costs may be lower; they may think the environment is better for raising children; people may be friendlier; there may be more room for a garden, chickens, or pets; and possibly other reasons. One man said he preferred to live in a village because the summer nights were cooler.

The reasons out-of-town workers gave for living in these villages are summarized as follows:

Reason given	*Percentage of households*
Have always lived here, this is my home, etc.	34
Own property here	4
Relatives live here	3
Like it here	5
Quieter here	3
People are friendlier	5
Better place to raise children	6
Couldn't get house in town where I work	17

Cheaper to live here	10
Rent lower	3
Convenient to work	5
Miscellaneous reasons	5

One-third of the out-of-town workers are obviously old residents who have obtained work out of town either because there is no local work available or because they can get higher pay elsewhere. If with these are included those who own property and those who have relatives in the villages, the conclusion is that two-fifths are old residents who now work out of town.

One-sixth of the out-of-town workers live in the villages because they could not find places to live in the towns where they work. Most of these apparently moved to the villages since the housing shortage developed, probably since 1943. It may be that the majority of those who say they live in the village because living costs or rents are lower are also relative newcomers.

The length of time workers have lived in their present towns will throw some light on the question.

Years of residence	*Percentage of household heads* — *Working out of town*	*Working in town*
Less than 1	14	6
1 or 2	13	9
3 or 4	18	14
5 or 6	9	6
7 or 8	7	7
9 or 10	4	7
More than 10	35	51

It will be observed that 27 percent of the out-of-town workers have lived in the villages two years or less and 54 percent have lived there six years or less. It seems safe to assume that the great majority of these families are not natives of these villages but moved there to find a place to live or because they like village life. Thirty-five percent of the households of out-of-town workers have lived in the villages more than 10 years. Most of these are probably old residents who have found work in other towns and continue to live in their village homes. Considering all the evidence, we may conclude that one-half or more of the out-of-town workers are relative newcomers in their villages and moved there because of ability to find a house, because rents are lower, because other living costs are lower, or because they like village life. This would indicate that 10 to 15 percent of all village households are those of workers in other towns who are relative newcomers in the villages. The percentage is higher in Area 1 and lower in Area 3.

How Village Residents Like Village Life

In order to ascertain how the respondents like life in the villages, they were asked: "Would you move to another town if you could find a place to live there?" The following tabulation shows a percentage distribution of the replies.

Reply	*Working out of town*	*Working in town*	*Retired*
Yes	31	16	10
No	60	81	83
Don't know	9	3	7

Thus, less than one-third of those working out of town say that they would move if they could find a place to live in another town.

Those who answered "yes" were asked: "Why do you want to move?" The percentages of those who gave

various reasons are shown, by employment location:

Reason given	*Working out of town*	*Working in town*	*Retired*
Like larger town	12	25	11
To get closer to work.....	62	8*	11*
To get closer to friends or relatives..	..	2	26
To get better jobs	7	43	19
Other reasons...	19	22	33

* Other members of household

The main reason why those working out of town would like to move is to be closer to work, whereas those working in town would like to get better jobs. They are satisfied to live where they are but would be willing to move if they could secure higher-paying employment.

Those who answered "no" were asked, "Why don't you want to move?" A percentage distribution of their reasons for not wishing to move is as follows:

Reason given	*Working out of town*	*Working in town*	*Retired*
Like it here...	32	19	21
This is home..	13	13	23
Like small town	7	5	..
Own home.....	21	13	21
Friends or relatives here	8	5	12
Cheaper here...	5	..	1
Too old to move	3	2	14
Work here.....	3*	34	4*
Other reasons...	8	9	4

* Other members of household

When those who said they did not want to move were asked whether they had ever considered moving, 84 percent of the retired households, 79 percent of those who work in their home towns, and 58 percent of the out-of-town workers said they had not done so. Thirty-eight percent of the out-of-town workers who reported that they had considered moving said that they had not done so because they couldn't find places to live; 15 percent because they like it "here"; 8 percent because they couldn't afford higher rent in larger towns; 7 percent because they own their homes; and 7 percent additional who own their homes, because they couldn't sell them; 2 percent because living costs are lower; and the others gave a variety of reasons.

These answers indicate that some of the respondents live in the villages only because they were able to find houses there, and that they would really prefer to live elsewhere. However, the great majority of village residents are satisfied with living conditions. The answers to these questions throw considerable light on the advantages of village life. A friendlier, quieter, better place to raise children, and lower living costs are very definite and often valuable reasons. It may be pointed out in passing that village life is not the drab, isolated existence which was so often pictured in the decades prior to the automobile, moving pictures, and radio. Village residents not only have the home entertainment of papers, magazines, and television and radio but community entertainment through school, church, and other local organizations. The automobile brings them close to the amusement, recreational, and cultural facilities of the larger towns. A resident of a small village put it this way: "I live 24 miles from a city of 50,000. In 30 minutes I can

be at any of the city stores, movies, lectures, athletic contests, entertainments, or cultural events. As for drive-in movies or roadside tea rooms near the city, I can get there as quickly as most of the city residents."

Getting to Work

Seventy-five percent of those who work out of town travel to work in their own cars, 9 percent in friends' cars, and 8 percent in car pools. Thus 92 percent travel by car. The others travel by bus, employers' truck, interurban, airplane, ship, and railroad. The three last-named types of transportation are used by those working long distances from their homes. The great majority (97 percent) said that they were satisfied with their transportation.

The majority of out-of-town workers have apparently given little thought to the cost of transportation. Less than half would attempt to estimate the cost. Of those who did make estimates, one-half thought it was less than 60 cents a day, and one-third, more than $1 a day.

How Place of Employment Affects Place of Shopping

SHOPPING GOODS

Do persons who work out of town do more shopping out of town than persons who work in the town where they live? In order to answer this question, the respondents were asked, "Where did your family last purchase woman's coat, woman's good dress, man's suit, man's shoes, groceries, and drugs?" Four of these articles are shopping items and two are convenience goods. Based on past experiences in trade area surveys, it was felt that these items are typical of the two classifications and would provide a reasonably accurate answer. This question was asked only of households that had lived in a village for two or more years. People who move to a different town bring shopping goods with them and do some of their shopping in their former homes until they become familiar with the stores in the new area. Two years was thought long enough for households to wear out most of the clothing brought along when they moved and to adjust their shopping habits to their new residences.

It was found that the households of persons who work in town, as well as those of persons who work out of town, buy most of their clothing out of town. These villages for the most part do not have stores carrying satisfactory assortments of shopping goods. Households of locally employed persons, however, do buy somewhat more of their clothing locally and somewhat less in the nearest large shopping center than do those of persons who work out of town. The following tabulation shows percentage distributions of places where clothing is purchased, classified by employment location of household head.

Place of clothing purchases	*Working out of town*	*Working in town*
Nearest large trading center	69	58
Home town	2	8
Chicago	3	5
By mail	3	3
Other towns	23	26

Distance is a factor in deciding where people trade. Households in Area 1 buy a larger portion of their

clothing in the nearest trading center than those in Area 2, and those in Area 2 buy more of their clothing in the nearest trading center than do those in Area 3. This is true both of households whose heads are employed out of town and of those whose heads are employed in town. This finding is in line with the law which says that the drawing power of a trading center decreases with distance. The households in Area 3 make only about one-third of their purchases of the apparel articles listed in the nearest shopping center. Several of the villages in Area 3 are approximately equidistant from two or more large shopping centers, and some are much closer to smaller shopping centers (towns between 5,000 and 10,000 population). Since a larger trading center has more gravitational pull or attraction than a smaller one, the nearest trading center is not necessarily the dominant one. The finding here agrees with those of trade area studies in that towns at some distance from primary trading centers divide their trade among more towns than do those close to a large trading center.

One other question arises: What effect does size of village have on the proportion of shopping done out of town? It happened that three of the seven villages in Area 3 had more than 1,000 population. It is to be expected that the stores in the larger villages carry larger assortments of apparel than do the stores in the small villages. Therefore separate tabulations were made for households with employed heads in the villages having populations between 1,000 and 2,500 and in those of less than 1,000. It was found that in the three larger villages 25 percent of the apparel articles listed were purchased in home-town stores, as compared with one percent for the four smaller villages.

CONVENIENCE GOODS

Most groceries and drugs are bought locally both by households with heads employed out of town and by those with heads working in town. However, the former buy more of their convenience goods out of town than the latter do. The place of employment seems to have more influence on the places where convenience goods are purchased than on those where shopping goods are purchased. It appears that many persons employed in trading center towns buy many of their groceries and drugs there and bring them home as they return from work. Percentages for the two groups, shown in the following tabulation, support these conclusions.

Place of convenience goods purchases	*Working out of town*	*Working in town*
Nearest trading center....	32	16
Home town.............	54	74
Near-by small town......	6	8
Other towns.............	8	2

As the distance from the trading center increases, fewer groceries are purchased in the trading center and more are purchased in the home town. This is true both of those who work in town and of the out-of-town workers.

Shall I Incorporate My Business?

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THOSE PRESENTLY ENGAGED in a business of their own, as well as those who contemplate the establishment of their own business venture, have a choice of three well-known forms of business organization by which they may accomplish their objectives. These are the single proprietorship, the partnership, and the corporation. Each has its own peculiar advantages and disadvantages, and the owner (or owners) after considering these as they relate to the nature, size, and possibilities of his business, makes his selection.

In selecting the most suitable form of organization for a business enterprise at least four questions should be given serious consideration. These questions are:

How important is it for me to retain a major voice in the control and management of the business?

What will be my personal liability for all obligations incurred by the business?

How will my interest in the business be affected by my death or the death of a co-owner?

How are the taxes which I may be compelled to pay affected by the form of organization selected?

Certain other considerations may be, and often are, involved, but these are the major questions to be answered in determining which form is best suited to the owner's needs.

Control of the Business Enterprise

One who seeks to own and operate his own business has in mind two, and perhaps three, basic goals. He desires an outlet for his business energies; he wishes to control the compensation he is to receive for the energy expended and the sacrifices made; and he may hope to find a place in which to invest accumulated assets over which he can exercise the maximum amount of personal supervision and control. If he operates the business as a single proprietorship, he has control over all three, except in so far as outside forces affect them. No one can discharge him; the profits he earns are the result of the energy, judgment, and wisdom displayed; and he alone determines the risk to which his capital is subjected. Profits once earned belong to him and he is free to use them as he sees fit. He may plough them back into the business or, if any remain after taxes are paid, he may withdraw them for personal expenditures, or he may withdraw either them or the capital for use in other ventures. Under this type of organization, the owner is in full control of all phases of the business, except as he must rely upon employees to aid him in conducting its operations.

Under the partnership form of organization the situation changes in several particulars. In the absence of some

restricting covenant in the partnership agreement, each partner shares with the others the control of the business and the profits which are earned. If new business policies appear desirable, they may be put into operation only after they have been approved by a majority of the partners. Admission of new members or a change in the nature of the business requires the approval of all partners unless these matters have been handled in the partnership agreement. In the absence of some different arrangement, the profits or losses are shared equally by the partners despite unequal investments or a disparity in the time and ability expended in the business. Since no salaries are allowed to partners for services rendered, the division of profits controls the reward received for capital risks assumed and business acumen displayed. If control by one partner is to be restricted or enlarged, if profits are to be divided otherwise than equally, if salaries or interest on investment is to be given, these matters should be clearly expressed in the articles of copartnership.

When the change is made from a single proprietorship or a partnership to a closed corporation — one in which the stock is closely held by a few stockholders — certain radical changes in control take place. Under the corporate form of organization, general supervision of all business activity is the responsibility of the board of directors. Consequently, the only manner in which one can control the corporation and the business which it conducts is to be able to control its board of directors by having enough of the capital stock to elect them. Since the board of directors selects the active paid personnel and determines the distribution of profits in the form of dividends, it is clear that a minority stockholder may find himself without any outlet for his business energies and without any choice in the disposition of profits. Under a partnership, profits may be withdrawn when earned and the shares in them are equal unless otherwise agreed. Under a corporation, the share in profits turns upon the amount of stock held, and the profits need not be distributed if the board of directors feels that they are needed in the business. Under a partnership, all members have an equal voice in its affairs, whereas under a corporation the directors engage the managing personnel, and the minority stockholder may find he has no substantial voice in the policies which are followed.

The general risk to which capital is subjected under the corporate form of organization is controlled by the corporate charter. Consequently, the nature of the business cannot be changed or altered without charter amendment, which requires somewhat more than a majority of the stockholders to accomplish. A stockholder who is dissatisfied with the policies which are pursued can indirectly withdraw his investment by finding a buyer for his stock, although contracts very often control or limit the right of sale in the case of a closed corporation.

From what has been said, it is apparent that the single proprietor who incorporates his business loses no control, since he will own substantially all of the stock and through the board of directors selected by him will be able to control all its policies. The partner who takes a minority interest in a cor-

poration loses little in control if the group to which he was formerly attached continues to work in harmony, but, if by reason of death or otherwise cooperative working arrangements cease to function, it is possible for him to lose substantially all control over the business. Many instances may be cited in which two or more members have joined their voting strength to exclude a minority owner from any active participation in company affairs, thus in time squeezing him out of the business entirely.

Personal Responsibility for Business Liabilities

Persons engaged in business often have assets in addition to those invested in their business. The extent to which these assets may be used by the creditors of the business to satisfy their claims in case the business venture fails is important both to the businessman and to his family, and is dependent somewhat upon the form of business organization which has been selected. If the business is conducted as a single proprietorship, no distinction is made between personal assets and business assets. All are equally available to unpaid creditors. Therefore, if the business fails, all assets of the owner, except those which are exempted by state statute, may be taken to satisfy the claims of creditors.

The situation is only slightly different in the case of a partnership. If the assets of the firm are inadequate to satisfy all the claims against it, the unpaid creditors may look to the individual assets of any one of the partners. However, if one of the partners is thus forced to pay more than his share of the losses, he may seek contributions from the other solvent partners. Nevertheless, if needed, all free assets of the various partners may be taken to satisfy firm debts.

One of the advantages a corporation has over other forms of business organization is that it is a legal entity separate and distinct from the members which compose it. This being true, no one is responsible for the debts of the corporation except the corporation. Since the stockholders have limited liability, it would appear that the maximum loss which could be occasioned a stockholder by the insolvency of the corporation would be the capital investment he originally made. This distinct advantage for the stockholder owner holds true only if he does not become a surety or guarantor for obligations of the corporation. Some writers go so far as to suggest that limited liability for stockholders of a closed corporation is somewhat of a myth, because the temptation for them to pledge their personal credit to enlarge the corporation's credit is irresistible.

To understand the situation fully, one must face actual operating conditions. Assume that a closed corporation desires to borrow money from its local bank to supplement its working funds. Some banks require all loans made to closed corporations to be guaranteed by the stockholders. Others review balance sheets, profit and loss statements, and past performance of management and approve or reject the application for funds as they would for a person, but if the credit rating is weak, security is required. Who is a more logical person to guarantee the loan than a stockholder? Similarly, if the business is ac-

customed to purchase merchandise or supplies on credit and credit has been exhausted, it is quite likely that the stockholders, in order to keep the disabled craft afloat, will guarantee payment for goods purchased.

It should be pointed out that though personal assets are pledged by stockholders to secure certain corporate indebtedness, the corporation still has some merit over other forms of business organization. The stockholder who loans money to a corporation or who is compelled to pay some of its obligations because of suretyship becomes a creditor of the corporation along with other creditors. To the extent that free assets are available, in the event of the bankruptcy of the corporation, he shares in the assets on the same plane as any other creditor. This is particularly important when the insolvency results from some catastrophe for which the shareholders are not personally liable.

The limited liability feature of a corporation is one of the reasons it often becomes necessary for a small business to incorporate in order to obtain additional capital for expansion. Persons willing to invest limited amounts are unwilling to assume personal responsibility for all debts thereafter contracted by the firm. Consequently, they insist that the business be incorporated and that their equity in the business be represented by shares of stock.

In summarizing this matter of personal liability for all debts and liabilities of the enterprise, it may be said that personal liability does exist for individual proprietors and for partners, but that limited liability is available to stockholders. This theoretical state for stockholders exists only so long as they refrain from pledging their personal assets as security for corporate indebtedness. Even then, it has some meaning since they become creditors of the corporation to the extent that they have paid its bills. Other factors being equal, the corporation is the better form of organization for the owner of a business because of the limited liability feature.

Death and the Business Enterprise

The business life of a corporation is not interrupted by the death of any one of its principal stockholders. Even though the deceased had been an active participant in the management, it is possible for the even flow of business to continue as usual. True, in the course of time it may become necessary to engage new managerial talent, but in the interim the business continues under the control of those currently employed. Their relation to the business enterprise is not altered by the death of a principal owner even though he may have been their superior officer. The time consumed in the settlement of his estate and the particular distribution of his assets do not necessarily prejudice the results obtained from the continued operation of the business. Inconveniences, such as the taking of an inventory, establishing assets and liabilities, or the location of a buyer for the business interest of a deceased owner, are not natural events growing out of the death of a stockholder in a closed corporation. The business of the corporation is separate and distinct from that of any of its stockholders and, as a consequence, such petty interruptions as are likely to occur in an individual proprietorship

or a partnership at death do not arise under the corporate form of organization.

The problems involved in drafting a satisfactory will for the disposal of property are increased when one of the major assets consists of a business, although if the business has been incorporated, the chances are that the problem will be somewhat simplified. In that case, if the situation dictates the continuation of the investment in the business, the stock ownership is merely transferred to those who are the natural objects of the deceased's bounty in the proportion he desires. If he wishes to leave one person a greater interest in the business than another, that is accomplished quite simply by leaving as many or as few shares of the stock to any one of his beneficiaries as he elects. It may be that one of his heirs is more interested in management than are the others, or better qualified to participate therein. Through the use of one device or another under the corporate form of organization, it is possible for the owner to distribute his business interests in such a manner as to accomplish the plan he has in mind.

Theoretically, at least, a business operated by an individual ceases when death overtakes him. All contracts of employment held by the employees are terminated by the death of the employer, leaving no one with authority to continue the business in operation. In many respects the business no longer exists as an independent unit, since its assets and liabilities become merged with the other assets and liabilities of the estate, which immediately fall under the control of the executor or administrator. Such a personal representative is obligated to dispose of sufficient assets to pay the debts and to distribute the remainder of the estate as is provided by will or, in the absence of one, in conformity with the state statute of descent.

The executor or administrator of an estate has no power to operate a business unless such authority has been conferred by will, or unless a statute permits operation under court supervision purely for the purpose of preserving the asset for the estate. If the will makes provision for the contingency, little difficulty develops unless the executor is unwilling to assume responsibility for the operation. In the latter case some member of the family who is to benefit from the terms of the will usually is willing to undertake, on a temporary basis, the personal risk that is involved in operation. Most of the problems which arise can be handled in a satisfactory manner under court supervision.

When plans are being made in anticipation of death and the business is to be continued after the death for the benefit of the family, difficulty is encountered. The sale of the business and the distribution of the proceeds are simple, but to provide for the continued operation of it with the exact shares in the management and profits which appear to be desirable for particular beneficiaries is extremely difficult without resorting to incorporation.

Turning attention to the partnership, it is discovered that many of the problems encountered are similar to those arising at the death of an individual. Upon the death of one of the partners, a dissolution of the firm is automatically effected and title to all firm assets

passes to the survivors, the title being held for a very limited purpose. In the absence of some agreement which controls the situation, it is incumbent upon the survivors to sell the assets, pay the liabilities, and distribute to the estate of the deceased partner, in cash, an amount equal to his share in the firm. The survivors, however, must dispose of the assets or business on the most advantageous terms possible, and have no right to operate the business for any other purpose than to facilitate its sale or liquidation. Any loss resulting from improper operation must be borne by the survivors.

Frequently, the partnership agreement or the will of the deceased is so drawn as to permit the survivors to buy the business or to operate it for a given period following the death of the partner. Such agreements are enforceable; where they are provided, the survivors may be permitted to operate the business for the period specified without accounting to the estate for the share of the deceased partner. Such an agreement is at best a makeshift affair because sooner or later a settlement must be had. The business is temporarily protected against the ill effects of a capital withdrawal and time is made available in which to bargain for the sale of the deceased's interest or for the inclusion of certain of his heirs in a new firm.

Rather extreme difficulty is encountered when a partner, in anticipation of death, seeks to maintain his investment in the business after his death on a permanent basis and to provide some of his beneficiaries with a voice in the management. A partnership is an exceedingly awkward vehicle through which to accomplish this purpose. It can be formed only when all members are willing to subscribe to the instrument which creates it. New members may not be admitted without the approval of all existing members, and beneficiaries of a will may not have a partnership forced upon them. A contract between existing partners whereby it is agreed that, upon the death of one of them, his heirs or certain of them will be admitted is the only feasible way to meet the situation. Even though the partnership is formed, there is no assurance that it will be continued for any agreed period of time, since it can be terminated again by death or by the will of any one of the partners.

The problem becomes increasingly complex if the prospective deceased desires several of his beneficiaries to share in his partnership interest. The requisite approval of the large number of people involved, the possibility of the desirability of divorcing ownership from management, and the necessary variation of capital interest in the business combine to make the partnership a very cumbersome device through which to achieve the will of the testator.

In summary, it is clear that the corporation enjoys certain advantages over other forms of business organization upon the death of an owner. It can more readily withstand the original shock resulting from the death, and it facilitates distribution of the estate of the deceased. These, along with other advantages of operating under the corporation, must be weighed against the possible tax disadvantages which may exist.

Taxes and the Business Enterprise

A comparison of the corporate form of organization with the sole proprietorship and the partnership has little value unless it includes a careful study of the differences in tax liability which are involved. When incorporation is seriously considered by a modest-sized enterprise, three tax questions promptly present themselves:

1. Other than income taxes, are the taxes growing out of incorporation likely to be substantial?

2. Will a change from the present form of organization to a corporation result in a taxable gain on assets which have appreciated in value prior to their transfer to the corporation?

3. Under which form of organization will there be the lowest annual income tax for the owners?

The first question raises no issue of any magnitude. There are certain franchise or license taxes which are assessed annually by the state against corporations, but they are so moderate in character that in the average case they may be disregarded. In addition, for firms employing a small number of persons, there is the possibility that by incorporating and employing the owners, the number of employees might be increased to the point where state and Federal unemployment taxes are payable. Furthermore, the taxes for old age benefits would, after incorporation, be applicable to the salaries paid to the owners within the limits established for other employees. As an offset against this latter disadvantage, it should be pointed out that they, as employees, would upon retirement be entitled to certain old age benefits. These three taxes mentioned when considered in total would not bulk large, but should of necessity be considered along with other taxes in reaching a final decision on the form of organization to be used.

The second question can be introduced best by the use of an illustration. An individual or a partnership proposes to transfer to the corporation for $25,000 in stock an asset the net cost of which was $10,000. Is the $15,000 profit a taxable gain? The Internal Revenue Code in essence provides that a transfer in exchange for corporate stocks or securities is not taxable if the transferor — or transferors — *immediately after the exchange* controls the corporation. If two or more persons join in making the transfer, they must take stock and securities in proportion to their previous interest in the property to escape taxation. The transferor is deemed to be in control of the new corporation if 80 percent of all kinds of stock is owned. If this situation exists at the time the plan of transfer has been fully consummated, the transfer does not become taxable merely because the control of stock changes at some later date.

The law does not require the interests of two or more persons in the securities received for property transferred to be identical with their previous interests in the assets, but the discrepancy must be relatively small or the gain becomes taxable. For illustrative purposes, assume that A, B, and C transferred property worth $1,000,000 to X Corporation, and that their previous interests were $50,000, $200,000, and $750,000, respectively. If each received those respective amounts in stock, there would be no taxable gain

regardless of what the property originally cost them, but if we assume that A received $52,500, B $182,500, and C $765,000, the proportions have been distorted and the likelihood of a tax strengthened. If the plan of incorporation calls for the proportions to be disregarded, the capital gain tax involved should be weighed along with other factors influencing the choice of organization.

The transfer of appreciated assets to a corporation tax-free is not necessarily a tax advantage, since the effect may be merely to defer the tax. A later sale by the corporation of the assets will, so far as profit or loss is concerned, be treated as though purchased for what they cost the original owners. Property costing A $10,000 but transferred to the corporation for $25,000 in stock if later sold for $30,000 results in a $20,000 gain for the corporation, since that would have been the gain had the original owner sold it. Furthermore, if A should later sell his stock, any amount received by him over and above the $10,000 would be a taxable gain, as for income tax purposes the stock is substituted for the asset previously owned by him.

Although tax liability on transfers to a corporation must be considered when an existing business is being incorporated, the determining factor for its owners, and the only one of substance for those starting a new business, is possible annual tax savings which may be effected by the use of one form of organization rather than another. When income taxes are involved, it should be borne in mind that the entire income earned by a sole proprietor or by a partner is taxable whether it is withdrawn by him or is left in the business. The rate for an individual is such that for a small income the tax is proportionately rather low, whereas for an exceedingly large income the tax may take as much as 77 percent of the income. On the other hand, the rate for a corporation ranges from 21 percent on an income of $5,000 to a maximum of 38 percent for incomes of $50,000 or more. Consequently, if double taxation can be avoided, the corporation tax is more favorable to a profitable business.

If the business income is to be paid annually to the owners, it is clear that tax savings by incorporation will not result, since the net income will be taxed twice. The corporation would pay the tax assessed against its income, and the dividends paid would be added to other income of the owners and be taxed again as part of their personal income. An old and established business that is not expanding and has no need for additional capital, so that its net profits would normally be withdrawn for use elsewhere, would operate at a distinct tax disadvantage under the corporate form of organization. All of its net income, after fair and reasonable salaries have been paid to the owners, is subject to the corporate tax, and when declared in dividends would again be taxable as income of the owners. To the extent that income is not needed in a business and cannot be absorbed by fair salaries, the corporation handicaps the owner by subjecting him to double taxation which, although it has been severely criticized, remains a feature of our income tax law. Within reason, the income of a corporation can be influenced by salaries paid to the owners, and it might be that very little

income would remain after salaries are paid. Salaries are a true expense of the business, however, only if they are reasonable when compared with salaries paid to other executives with similar responsibilities and if they are paid for services actually rendered. Otherwise, salaries paid will be treated as dividends and thus be subjected to double taxation.

If the stock of a corporation is closely held and the owners do not need all of the income each year, and if the income fluctuates substantially from period to period, there could be a leveling of the income to avoid high surtax rates in prosperous years by not declaring all the income earned in a particular year. The Internal Revenue Code, however, provides for a penalty of 27½ percent on profits which are retained by a corporation for the purpose of avoiding high taxes by the stockholders. The Federal government scrutinizes the returns of closed corporations to determine whether profits are unreasonably retained in the business.

The penalty is assessed on profits retained only if they are not reasonably needed for expansion, to liquidate indebtedness, to survive intensified competition, to meet contingencies, or to aid any sound and well-planned project. Consequently, if a business is growing and needs the addition of profits to finance its expansion, it is possible that only the corporate tax will be assessed against the profits. If the corporate tax is substantially less than the amount which would be paid by individual owners, a real tax saving results from incorporation. To indicate the possible saving or loss which could result under given conditions, some tables are presented here.

Table 1 suggests the tax saving or loss for a corporation as compared with a sole proprietorship, it being assumed that the owner is married but has no other dependents. A slight advantage in favor of the corporation develops when the net income reaches $25,000, and at $50,000 a substantial saving occurs. Attention should be focused upon the bearing that salaries paid to owners have on the tax saving. If this business at the $100,000 income had paid a salary of only $30,000, an additional tax

TABLE 1. TAX SAVING OR LOSS RESULTING FROM INCORPORATION BY SOLE PROPRIETOR (MARRIED)

(No dividends declared)

Net income of business before taxes and salaries	Sole proprietor	Corporation				Tax saving (+) or loss (−)
	Total tax, using joint return	Salary to owner	Tax on salary	Tax on corporation	Total taxes	
$ 10,000	$ 1,621	$ 8,000	$1,206	$ 420	$ 1,626	$− 5
25,000	5,877	12,000	2,079	2,890	4,969	+ 908
50,000	17,201	18,000	3,649	9,460	13,109	+ 4,092
100,000	46,403	40,000	12,178	22,800	34,978	+11,425

saving of $590 would have been realized, whereas if the salary had been increased to $50,000, the tax saving would have been reduced by $1,223.

This table also assumes that the owner has no income other than that derived from the business. As the amount of income from other sources increases, the individual tax rate becomes higher and the advantages gained by incorporation are reached at a much lower level of business income. Thus, the table shows a $5 loss from incorporation with the net income of $10,000, but a $200 outside income by the owner would have turned it into a $2 saving. As the amount of outside income becomes substantial, the gains from incorporation become more pronounced.

Table 2 compares taxwise a corporation and a partnership composed of two members. It assumes that they share equally in the profits and take equal salaries from the business. Because there are more people among whom to divide the income, no tax saving occurs until the firm income exceeds $50,000. Here again the picture is influenced by outside income or by possible unequal salary payments. It is easily conceivable that one of the owners might benefit taxwise from incorporation, whereas the other would suffer a tax loss.

Because of the double taxation applied to dividends, the tax saving or loss is modified substantially by the payment of dividends. In Table 3 it is assumed that 50 percent of the net income, after salaries and corporate taxes, is paid out in the form of dividends. For the sole proprietor with an income of $50,000 from the business, the tax saving drops from $4,092 to $254, and for an income of $100,000 from $11,425 to $1,794. Tax advantages gained from incorporation are soon dissipated if substantial dividends are declared.

Maximum tax savings are achieved by incorporation only when the profits are left in the business until the owner's death. At that time new values for the stock are established and no income tax on accumulated profits is payable. If the profits are withdrawn indirectly by liquidation of the corporation or by sale of the stock at a price enhanced by the

TABLE 2. TAX SAVING OR LOSS RESULTING FROM INCORPORATION BY PARTNERSHIP (TWO PARTNERS; EACH MARRIED)

(No dividends declared)

Net income of business before salaries and taxes	Partnership	Corporation				Tax saving (+) or loss (−)
	Taxes paid by partners using joint returns	Total salaries to owners	Tax paid on salaries	Tax on corporation	Total taxes	
$ 10,000	$ 1,262	$ 8,000	$ 930	$ 420	$ 1,350	$− 88
25,000	4,387	12,000	1,638	2,890	4,528	− 141
50,000	11,754	18,000	2,799	9,460	12,259	− 505
100,000	34,402	40,000	8,495	22,800	31,295	+3,107

TABLE 3. TAX SAVING OR LOSS RESULTING FROM INCORPORATION BY SOLE PROPRIETOR (MARRIED) WHERE DIVIDENDS ARE DECLARED

(50% of profits declared in dividends)

Net income of business before salaries and taxes	Sole proprietor	Corporation				Tax saving (+) or loss (−)
	Total tax using joint return	Salary to owner	Tax on salary and dividends	Tax on corporation	Total taxes	
$ 10,000	$ 1,621	$ 8,000	$1,359	$ 420	$ 1,779	$− 158
25,000	5,877	12,000	3,371	2,890	6,261	− 384
50,000	17,201	18,000	7,487	9,460	16,947	+ 254
100,000	46,403	40,000	21,809	22,800	44,609	+1,794

accumulated profits, a capital gain is realized. The net savings or losses which will take place under these circumstances are shown in Table 4. Naturally, no over-all tax advantage results from incorporation under these conditions until the income reaches a somewhat higher figure than would otherwise be necessary.

In conclusion, it should be emphasized that each individual situation must be worked out carefully on the basis of the particular facts involved. Probably no generalizations should be drawn, but if double taxation can be avoided and if half of an individual's business income which ranges between $25,000 and $50,000 can be ploughed

TABLE 4. ULTIMATE TAX SAVING OR LOSS RESULTING FROM INCORPORATION BY SOLE PROPRIETOR (MARRIED)

(No dividends declared)

Net income of business before salaries and taxes	Sole proprietor	Corporation					Ultimate saving (+) or loss (−)
		Controllable income					
	Total cash in hand	Salary after taxes	Equity in corporation after taxes	Total	Capital gain tax on liquidation	Total cash in hand finally received	
$ 10,000	$ 8,379	$ 6,794	$ 1,580	$ 8,374	$ 153	$ 8,221	$− 158
25,000	19,123	9,921	10,110	20,031	1,292	18,739	− 384
50,000	32,799	14,351	22,540	36,891	3,838	33,053	+ 254
100,000	53,597	27,822	37,200	65,022	9,300	55,722	+2,125

Note: This table shows the same facts and salaries as Table 1, but business is liquidated or stock sold, resulting in a long-term capital gain in which accumulated profits are realized.

back into the business, incorporation usually results in a tax gain. Again, the warning should be given that other factors in addition to taxes merit scrutiny when the choice of organization for business is under consideration, although tax advantages or disadvantages must be weighed carefully.

NOTE: This article is a summary of material gathered for a longer study, to be published later in bulletin form.

Books Reviewed

Federal Tax Reform. By Henry C. Simons (Chicago: The University of Chicago Press, 1950, pp. x, 161. $3.50)

When Henry Simons died in 1946, he left behind a manuscript on Federal tax reform, written for the Committee for Economic Development in 1943; this material is presented in unrevised form in the present volume. Despite the lapse of time, only minor details are out of date, since the study stresses fundamental problems of the tax structure, which have not altered significantly since 1943.

Simons' work in taxation was characterized by its penetration and comprehensiveness. He was not concerned with patchwork modification of a tax structure which he regarded as fundamentally defective, but rather with a complete overhaul. His plans involved replacement of the present complex of taxes by a simple, logically consistent personal income tax, one which would combine maximum equity with minimum adverse effect upon the economy and with avoidance of arbitrary distinctions characteristic of the present law. All Simons' work, in the tax field as elsewhere, was conditioned by his fundamental interest in the restoration of a high degree of competition in the economy, especially through encouraging the growth of new businesses.

More specifically, Simons argued for complete elimination of two major Federal taxes — the excises, including those on liquor and tobacco, which he particularly condemned, and the corporation income tax. The evils of taxing corporations as such are stressed. As a basic feature in the reconstruction of the personal income tax, capital gains would become fully taxable, with realization considered to occur at death or upon gift of the property. Simons regarded complete taxation of capital gains as an adequate method of taxing corporation undistributed profits; the latter would not be subject to taxation at all until the stockholders realized on them as capital gains. He recognized that this policy — which he would also apply to reinvested earnings of partnerships and proprietorships to avoid discrimination — would mean permanent loss of revenue when gains were eventually nullified by losses, but he defended it strongly on the basis of the assistance it would provide to the growth of small businesses.

A second major reform would deemphasize the use of relatively short time periods for tax purposes — a major source of arbitrary distinctions. Extensive averaging of irregular incomes over a period of years would be permitted, as well as almost complete freedom for firms in determining depreciation and obsolescence deductions in particular years. With full taxation of capital gains such freedom would offer little chance for permanent escape from taxes.

Finally, the scope of the income tax would be modified to cover elements now exempt, such as state and local bond interest and the rental value of owner-occupied homes. The suggestion is made that gifts be treated as income, but the point is not developed. Death taxation is not considered in any detail.

Against many of Simons' conclusions serious objections can be raised; for example, the failure to tax undistributed profits on a current basis is highly debatable. But the contribution which he has made — in previous writings and in this book — in emphasizing the need for the integrated treatment of all income and for the avoidance of arbitrariness and inequity arising from overemphasis on short time periods is very substantial. His condemnation of excises and the present treatment of capital gains and corporation profits stresses widely recognized evils. Simons' writings may be of little use in facilitating year-to-year modification in the tax laws — the only practicable path to tax reform. But they are of very great assistance in the sound development of the ultimate goals of tax policy.

The usefulness of Simons' writings is greatly increased by his lucid style, although some sections presume a considerable knowledge of the tax laws. The publishers, however, rendered a serious disservice to the reader by the placing of the footnotes, which contain much excellent material, at the end of the book.

JOHN F. DUE

Income, Saving, and the Theory of Consumer Behavior. By James S. Duesenberry (Cambridge: Harvard University Press, 1949, pp. 124. $2.50)

The central aim of this little volume is a re-examination of consumer behavior with a view toward resolving the apparent inconsistency. Although the percentage of income saved in any one period varies with income level and the per capita income of the population has risen steadily over the past 80-odd years, no perceptible increase in the proportion of aggregate income saved has been detected over this period. This is true even though the aggregate savings rate fluctuates sharply with changes in aggregate income within the so-called business cycle. Duesenberry points out that the traditional theory on the subject, which postulates the dependence of aggregate consumption on aggregate income, either at current prices or deflated for price variations, is inadequate because it implies a rising rate of saving over time.

The book begins by pointing out this apparent paradox and then proceeds, in Chapter II, to a neat and simple review of the classical development of the theory of consumers' choice by means of the so-called marginal-utility approach. This approach is based on the assumptions that consumers are able to order their preferences for particular commodities and that they distribute a given income in such a way as to maximize the satisfaction, or utility, obtainable from these goods. Another assumption that has been used in the development of this approach is the independence of consumer preferences, namely, that the preferences of one consumer are determined independently of the preferences of any other consumer. Duesenberry challenges the validity of this proposition, asserting that in fact people seek to emulate their more prosperous neighbors, with the result that consumer preferences are influenced by how other people act.

The logical and psychological bases for this view are discussed in Chapter III, and some statistical evidence in its support is presented in Chapter IV.

Chapters III and IV are also con-

cerned with long-term trends in the aggregate savings ratio. These chapters develop the theory that the aggregate savings ratio is independent of the level of income and that an individual's propensity to save in the long run varies not with his absolute income but with his relative position in the income distribution. In support of this theory, Duesenberry cites the absence of any trend in the savings ratio from 1879 to 1938 despite a fivefold increase in national income during this period. And from the 1935-36 *Consumer Purchases Study,* he notes that the percent of income saved is the same for negro and white families in Columbus and in New York when families at the same position of the income distribution are compared.

In Chapter V, Duesenberry turns to the problem of explaining short-run fluctuations in the aggregate savings ratio and asserts that savings depend on past as well as on current income. Since people continually strive for a higher standard of living and are very reluctant to lower their standard of living, he maintains that the most relevant past income variable is one's previous peak income. From this he develops the hypothesis that the aggregate savings ratio in the short run is determined by the ratio of aggregate current income to past aggregate peak income, a function which he tests empirically and finds satisfactory.

The book closes with a chapter discussing some practical implications of the theory of interdependent consumer preferences developed in Chapters III and IV, and with a concluding chapter summarizing the results of the study.

On the whole, the book is very well written and presents some interesting ideas. If, however, it was intended to present a single unified theory of consumer behavior, it does not seem to have succeeded. One encounters loose ends and even inconsistencies in reading the book, and in this reviewer's opinion its organization could have been considerably improved. Although this is not the place to discuss the technical aspects of the work, a few general comments would seem to be in order.

In one part of the book, the interdependence of consumer preferences and the "emulation motive" is stressed as influencing the individual's savings ratio. But in his empirical analysis of short-run fluctuations the savings ratio is assumed to depend only on the ratio of current to past income; no attempt is made to reconcile this theory with the idea of interdependence. In his empirical analysis, Duesenberry develops the dependence of the savings ratio on current and past income in terms of individual behavior and then carries over the identical functions to aggregate terms (pp. 89-90). In doing so, however, he completely ignores the so-called problem of aggregation, that is, the mathematical problem of "blowing up" a function valid for the individual to national proportions. A cursory examination of the problem by this reviewer reveals that Duesenberry's aggregate function can apparently be derived from his hypothesis for the individual only under some very awkward assumptions, such as, for example, that the variance of incomes is constant from year to year, that all individuals attain a peak income in the same year, and that an individual's current income is independent of his past peak income.

One might also question the form of Duesenberry's short-run function: the assumption that past peak is just as relevant if this income were reached last year as, say, ten years ago, would seem dubious at the least. In fact, some work done by this reviewer with this function has yielded evidence of high serial correlation of the residuals, leaving the implication that the function is omitting some other highly relevant factors.

Duesenberry is to be commended for his development of the notion of the interdependence of consumer preferences, for this would seem to be a valuable contribution to the theory of consumer behavior. However, the present book provides at best a stepping stone, and a great deal more work remains to be done before a satisfactory and unified theory of consumer behavior in terms of both the individual and national aggregates is evolved.

ROBERT FERBER